

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Unbundled Access to Network Elements)	WC Docket No. 04-313
)	
)	
Review of the Section 251 Unbundling)	WC Docket No. 01-338
Obligations of Incumbent Local Exchange)	
Carriers)	

AFFIDAVIT OF

SUSAN M. BALDWIN

on behalf of the

New Jersey Division of the Ratepayer Advocate

September 30, 2004

REDACTED – FOR PUBLIC INSPECTION

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I. INTRODUCTION

1. My name is Susan M. Baldwin. I am an independent consultant, and my business address is 17 Arlington Street, Newburyport, Massachusetts, 01950. I provide consulting services to public sector agencies on telecommunications economics, regulation, and public policy. My statement of qualifications is included as Attachment SMB-1.

2. I submitted testimony on February 2, 2004, on behalf of the New Jersey Division of the Ratepayer Advocate (“Ratepayer Advocate”) in New Jersey Board of Public Utilities Docket No. TO03090705, which addressed impairment for mass market unbundled switching, high capacity loops, and transport. I also provided technical assistance to the Ratepayer Advocate in the “hot cut” portion of the same proceeding.

3. I also prepared testimony in two other jurisdictions which analyzed the mass market switching impairment filings submitted by incumbent local exchange carriers (“ILECs”). In Arkansas, on behalf of the Office of the Attorney General, I analyzed the filing submitted by SBC Communications Inc. (“SBC”) in Arkansas Public Service Commission Docket No. 03-

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171-U.¹ On behalf of the Utah Committee of Consumer Services, I analyzed the filing submitted by Qwest Corporation (“Qwest”) in Utah Public Service Commission Docket No. 03-999-4.²

4. As a result of preparing comprehensive testimony regarding the impairment filings submitted by Verizon New Jersey (“Verizon NJ”), SBC Arkansas, and Qwest, and analyzing the competitively sensitive data submitted by those ILECs and competitive local exchange carriers (“CLECs”) in three states, I acquired an in-depth familiarity with granular local telecommunications data, specific to various product, geographic, and customer class markets. Based on my first-hand knowledge of this detailed market-specific information, I applied the standards and rules set forth by the Federal Communications Commission (“FCC” or

¹*In the Matter of the Implementation of the Impairment Review Mandated by the Federal Communications Commission in its Triennial UNE Review*, Arkansas Public Service Commission Docket No. 03-171-U. I analyzed SBC's filing of February 2004, in which SBC sought a finding of non-impairment for mass market unbundled voice grade switching in the Little Rock LATA. I was asked to file testimony analyzing whether SBC's filing satisfied the triggers set forth by the FCC in its *Triennial Review Order* and addressing the implications of the proceeding for consumers in Arkansas. My testimony, although complete, was not filed as a result of the ruling by the U.S. Court of Appeals for the District of Columbia in *USTA v. FCC* vacating the FCC's delegation of authority. 359 F.3d 554 (D.C. Cir. 2004) (“USTA II”), *pets. for cert. filed*, Nos. 04-12, 04-15, 04-18 (June 30, 2004). See also *United States Telecom Ass'n v. FCC*, No. 00-1012, Order, (D.C. Cir. Apr. 13, 2004) (granting a stay of the Court's mandate through June 15, 2004) (“USTA II Stay Order”). The USTA II mandate issued on June 16, 2004.

²*In the Matter of a Proceeding to Respond to the Federal Communications Commission Triennial Review Order Released August 21, 2003*, Utah Public Service Commission Docket No. 03-999-04. On behalf of the Committee of Consumer Services, I analyzed Qwest Communications Inc.'s claim of non-impairment in Utah markets, performed a "trigger analysis," and addressed the implications of the proceeding for consumers in Utah. My testimony, although complete, was not filed as a result of the Appeals Court remand.

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“Commission”) in its *Triennial Review Order*³ in order to determine whether and where impairment exists.

Purposes of Affidavit

5. The Ratepayer Advocate asked me to prepare this Affidavit to supplement and to provide further factual support for its comments in the instant proceeding. One of the purposes of this Affidavit is to “highlight[] factual information that would be relevant under the guidance of *USTA II*” and to provide, to the extent permitted by the proprietary agreements governing the New Jersey proceeding, the “underlying data, analysis and methodologies necessary to enable the Commission and commenters to evaluate the factual claims meaningfully, including a discussion of the basis upon which data were included or excluded.”⁴ In this Affidavit, I refer to, and to the extent permissible (as constrained by proprietary agreements that govern the treatment of data in the state proceeding), summarize data specific to local markets in New Jersey.

³*Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003) (“Triennial Review Order”), corrected by Errata, 18 FCC Rcd 19020, 19021, paras. 12-13, 15, 17 (2003) (“Triennial Review Order Errata”), vacated and remanded in part, affirmed in part, *USTA II*, 359 F.3d 554.

⁴*In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, *Order and Notice of Proposed Rulemaking*, released August 20, 2004 (“NPRM”), ¶ 15.

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6. Other purposes of this Affidavit are to address how to: (1) define relevant product, geographic and customer class markets;⁵ (2) establish transition mechanisms that “would help to prevent service disruptions during cut-overs from unbundled network element (“UNE”) facilities to a carrier’s own (or third-party) facilities, or for conversions to tariffed or other service arrangements”;⁶ and (3) apply the FCC’s unbundling framework “to make determinations on access to individual network elements.”⁷ This Affidavit provides specific recommendations regarding how the FCC should modify its unbundling framework to respond to the concerns raised by *USTA II* and also to eliminate ambiguity that now exists in the network unbundling rules.

7. This Affidavit summarizes how the FCC should apply its network unbundling framework to New Jersey markets, and more generally how the FCC should apply its framework to local markets. The recommendations in this Affidavit seek to improve the prospect of local competition for residential and small business mass market customers and to minimize the potential for service disruption when consumers migrate from one telecommunications supplier to a competing supplier.

The industry’s unique access to proprietary data should not prevent consumer advocates from making informed assessments of impairment in local markets.

⁵*NPRM*, ¶ 9.

⁶*NPRM*, ¶ 10.

⁷*Id.*, ¶ 11.

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8. Pursuant to the proprietary agreement in New Jersey's impairment proceeding and the FCC's confidentiality requirements, I am providing two versions of my Affidavit, which relies extensively on proprietary data that I examined in the Board of Public Utilities' ("Board") impairment proceeding. In the public version of my Affidavit (and the referenced attachments), I have redacted information that has been designated as confidential in New Jersey's impairment proceeding.⁸ In the confidential version of my Affidavit (and the referenced attachments), I include proprietary information, which is intended to assist the FCC with its granular analysis of relevant markets in New Jersey.

9. Should any of the industry participants, whether ILECs or CLECs, submit proprietary data in either their initial or reply comments in this proceeding, the Commission should afford other parties, particularly regulatory and consumer advocacy agencies (participants with the greatest potential for unbiased review of such data), ample opportunity to review these data and to propound discovery as necessary to obtain the data in the granular fashion necessary to assess impairment. In New Jersey, although Verizon NJ submitted some market data with its filing, the Ratepayer Advocate, Staff, and other parties to the proceeding nevertheless issued numerous data requests to Verizon NJ and to CLECs. The data that local exchange carriers provided in response to these information requests were essential to my ability to analyze relevant markets.

⁸The Board instructed parties to BPU Docket No. TO03090705 to work out the appropriate arrangements to use proprietary data in their filings with the FCC. The Ratepayer Advocate has informed me that the appropriate arrangements have been made to enable me to include data deemed to be proprietary.

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10. Based on my participation in three state proceedings in which state regulators were investigating ILECs' impairment claims, I believe that it is highly unlikely that any ILEC, in a submission to the FCC, will submit data that is sufficiently granular to permit a sufficiently informed assessment by the Commission of the merits of the filing. Analysis of CLECs' granular data is necessary in order to assess where self-provisioning CLECs are *actually* serving residential and small business consumers. For these reasons, discovery opportunities are essential to an impartial and adequately informed consideration of where and whether impairment exists in ILEC-dominated local markets.

11. Accordingly, as a threshold matter, the FCC should first assess whether it has sufficient access to granular data about local markets to make an informed determination regarding impairment. Then, the FCC should consider whether participants to the proceeding have had adequate opportunity to review such data, and to seek clarification and/or further disaggregation of such data from ILECs and CLECs. Without these two steps, the FCC cannot fulfill the directives of the 1996 Act⁹ or of *USTA II*. Furthermore, residential and small business consumers, who cannot themselves supply these allegedly proprietary data, should not be harmed by a process which lacks adequate information. Based on my review of proprietary data in New Jersey, I urge the Commission to find that impairment exists for mass market local switching in New Jersey.

⁹Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. Hereinafter, the Communications Act of 1934, as amended by the 1996 Act, will be referred to as "the 1996 Act," and all citations to the 1996 Act will be to the 1996 Act as it is codified in the United States Code.

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12. I understand that the Commission is eager to establish unbundling rules and to provide some regulatory certainty and stability.¹⁰ Although I share this objective, the pursuit of this objective should not come at the expense of consumers. Any ILEC that seeks a finding of non-impairment should make a concerted and good-faith effort to submit a comprehensively documented filing in a timely manner, and to respond to discovery requests expeditiously and completely. Similarly, any CLECs that oppose any particular ILEC filing should be obligated to submit similarly granular data for the markets in question, and, in the absence of such CLEC cooperation, the Commission should afford such opposition the weight that the unsupported opposition merits.

¹⁰*NPRM*, ¶ 16.

II. BACKGROUND

13. The FCC seeks comment on how it might amend its interpretation of “impairment” as that term is used in section 251(d)(2)(B) of the 1996 Act, and also on how it should apply various factors when it determines whether an ILEC must provide particular unbundled network elements to competitors.¹¹ The Court, in its *USTA II* decision, determined, *inter alia*, that the FCC had unlawfully delegated certain authority to states in the determination of whether impairment exists in particular markets. It is my understanding that the FCC now seeks to “reclaim” that authority, and, in so doing, to issue final network unbundling rules that respond to the concerns expressed in *USTA II*. Furthermore, it is my understanding that the FCC must now, informed in part by states’ proceedings through the various submissions in the instant proceeding, must review and evaluate ILECs’ specific claims of non-impairment in particular markets. Where the FCC lacks the relevant information to make such determinations, and/or if the FCC determines that the information in the instant proceeding is stale, then I would expect the FCC to issue data requests to the industry to obtain the necessary granular evidence necessary to make informed decisions.

The FCC’s resolution of this proceeding will affect consumers’ choices and the type of local competition that will occur.

14. At the broadest level, the outcome of this proceeding will affect whether and where economically sustainable local competition can develop. The investigation raises significant

¹¹*NPRM*.

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economic, market structure, and public policy issues, the resolution of which directly affects consumers' choices and the extent to which local competition can occur. Local competition is precarious. In reaching this conclusion, I have examined, among other information, the following data regarding New Jersey's local markets:

- UNE loops in service by wire center.
- UNE-P disconnects on a statewide basis for the period spanning January 2001-October 2003.¹²
- UNE loops previously cut over to CLECs, which were subsequently cut back to Verizon NJ switches for service by Verizon NJ.¹³

15. These granular data provide a critical context for examining the economic and market structure issues that this proceeding raises, anchoring the Commission's review of Verizon NJ's filing with important market structure information. Some of the findings that are relevant to this proceeding are:

- CLECs' position in the local market is tenuous: The number of UNE loops that were originally cut over to CLECs, but then subsequently cut back to Verizon NJ ("win-backs") has <<<**BEGIN PROPRIETARY** >>>**END PROPRIETARY** over a one-year period. In 2002, customers that had been served

¹²Data regarding disconnections of UNE loops are unavailable on a wire center "without a special study." Verizon NJ response to RPA-TRO-58.

¹³Verizon NJ response to RPA-TRO-70.

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through competitors' UNE loops "swung back" <<<**BEGIN PROPRIETARY**
END PROPRIETARY>>> to Verizon NJ. In 2003, during the ten-month period between January and October, customers swung back <<<**BEGIN PROPRIETARY**
END PROPRIETARY>>> to Verizon NJ, an amount, which if annualized, would be <<<**BEGIN PROPRIETARY**
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- The number of *disconnections* of residential UNE-P in each of the years 2001, 2002, and 2003 (through October), were < < < **BEGIN PROPRIETARY**

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- As of June 2003, Verizon NJ supplied < < < **BEGIN PROPRIETARY**
END PROPRIETARY > > > UNE-P statewide to residential end users, < < < **BEGIN PROPRIETARY**
END PROPRIETARY > > > UNE-P to business end users, and < < < **BEGIN PROPRIETARY** **END PROPRIETARY** > > > UNE loops throughout the state.¹⁶

These data demonstrate the volatility within the industry and the vulnerability of CLECs to churn and to regulatory uncertainty during this nascent period.

¹⁴Verizon NJ response to RPA-TRO-70.

¹⁵Verizon NJ response to RPA-TRO-58.

¹⁶Verizon NJ responses to RPA-TRO-55 and RPA-TRO-57.

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16. Despite the efforts of state and federal regulators to eliminate market barriers, successful entry to ILEC-dominated markets is not easy and requires CLECs to overcome (1) customer inertia, (2) economic and operational impediments, and (3) more than a century of Verizon NJ's dominance in New Jersey's local markets. Based on the FCC's statistics, Verizon NJ dominates the vast majority of the local market either directly through its own retail services or indirectly by leasing its wholesale facilities to its competitors (*i.e.*, the non-facilities-based competition that occurs through resale, UNE-P, and UNE loop).¹⁷ Even if viewed solely on a retail basis (which would be misleading because it would mask CLECs' reliance on the incumbent carrier's facilities), Verizon NJ dominates 81 percent of New Jersey's local markets.¹⁸

The changes in the local market since February 2004 have diminished the prospects for residential and small business competition.

17. I submitted my testimony to the New Jersey Board in February 2004. In the intervening eight months, the prospect of competitive choice among suppliers of basic local telecommunications services for mass market consumers has suffered serious setbacks. AT&T

¹⁷CLECs owned fewer than 92,000 out of the total 6.5-million end-user switched access lines in service in New Jersey as of December 31, 2003. Federal Communications Commission, Wireline Competition Bureau, Industry Analysis Division, *Local Telephone Competition: Status as of December 31, 2003*, (June 2004), at Table 10: "CLEC-Reported End-User Switched Access Lines by State (as of December 31, 2003)."

¹⁸*Id.*, at Table 6: "End-User Switched Access Lines Served by Reporting Local Exchange Carriers (As of December 31, 2003)."

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announced plans to stop marketing its residential telephone service.¹⁹ One article characterized the decision in this manner:

AT&T's move is a potential windfall for the Bells . . . which have been increasingly successful in selling packages of local and long distance. Mr. Dorman said AT&T's decision to withdraw was clinched by a recent regulatory setback that will make it more expensive for AT&T and others to rent the Bells' lines to sell similar packages. MCI Inc. and Sprint Corp. also have throttled back on advertising and marketing.²⁰

Press reports indicate that both AT&T and MCI are for sale, given the right deal.²¹ Many of the smaller competitors are also scaling back marketing and expansion plans.²² Although ILECs may tout Voice over Internet Protocol ("VoIP") as gaining consumer appeal, as I discuss in Section IV, this technology does not yet represent an economic substitute for basic local exchange service.

18. The approximate eight-month passage of time between my preparation of testimony in New Jersey BPU Docket No. TO03090705 and my preparation of this Affidavit potentially raises

¹⁹Four months ago, AT&T announced its plan to pull out of seven states. "AT&T: No New Home Customers in 7 States," Reuters, June 23, 2004, http://news.yahoo.com/news?tmpl=story&u=/nm/20040623/bs_nm/telecoms_att_local_dc

²⁰"AT&T Posts 80% Drop in Net, Confirms Consumer Retreat," *The Wall Street Journal*, July 23, 2004, page A11.

²¹"Bride or Bridesmaid? AT&T and MCI May Compete for Suitors," *The Wall Street Journal*, August 2, 2004, page C1.

²²"Without rules in place that support vibrant competition in the telecommunications marketplace, competitive carriers and consumers are now unfortunately faced with great uncertainty," said Donald Davis, Z-Tel's senior vice president-industry policy, in the June 21 letters. "The victims of this dramatic shift in federal policy and the resulting uncertainty will be consumers." "Z-Tel to Cease New Residential Business in Eight States," *TR Daily*, June 22, 2004.

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two concerns. However, as I explain below, neither of these concerns undermine or alter my conclusion that Verizon NJ has failed to demonstrate that there are *any* areas in New Jersey within which the elimination of unbundled mass market switching would not impair CLECs.

19. The first concern is simply that, with each passing day, CLECs' may enter and exit markets, may gain or lose customers, and may shift their mode of entry. Conceivably, over an eight-month period, the competitive landscape could have changed materially. In order to assess generally the impact of the passage of time on the local market structure, I compared publicly available FCC-provided local competition data for June 2003 (the most recent FCC data available when I submitted my testimony) and for December 2003 (the most recent FCC data available when I prepared this Affidavit). As Table 1 below shows, New Jersey CLECs slightly increased the use of their own lines to serve customers (mass market and enterprise), with a rise of approximately 3 percent. In sharp contrast, during the same time period, New Jersey CLECs' use of UNEs – UNE-Platform (“UNE-P”) and UNE-Loop (“UNE-L”) – to serve customers increased by approximately 26 percent, with an approximate 28 percent increase in their use of UNE-P and only a 2 percent increase in their use of UNE-L. Clearly, the availability of UNEs, especially UNE-P, is essential to CLECs' efforts to establish themselves in the competitive marketplace, and to mass market consumers' opportunities for competitive choice.

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Table 1
Consumer Choice Depends on UNEs, Particularly UNE-P

New Jersey	June 2003	December 2003	Growth
CLEC-owned	88,858	91,922	3 %
UNE Loops	63,168	64,423	2 %
UNE Platform	697,936	892,997	28%
Total UNEs	761,140	957,420	26%
Resold Lines	239,113	219,548	-8%
Total CLEC Retail Lines	1,089,075	1,268,890	17%
Verizon NJ Retail Lines	5,389,747	5,231,266	-3%
CLEC Share of Total	17%	20%	
Total US	June 2003	December 2003	Growth
CLEC-owned	6,275,655	6,935,358	11%
UNE Loops	4,205,000	4,260,000	1%
UNE Platform	13,026,000	15,161,000	16%
Total UNEs	17,231,000	19,421,000	13%
Resold Lines	4,887,321	4,726,260	-3%
Total CLEC Retail Lines	28,393,976	31,082,618	9%
ILEC Retail Lines	155,922,118	151,837,752	-3%
CLEC Share of Total	15%	17%	

Sources: *Local Telephone Competition: Status as of June 30, 2003 and December 31, 2003*, Industry and Analysis Division, Wireline Competition Bureau, Tables 3, 4, 7, and 10. *RBOC Local Telephone Data as of December 2003 and June 2003*. The total UNEs shown are the calculated totals of the quantities shown for UNE-L and UNE-P; these values differ slightly from the total UNEs reported in the *Local Telephone Competition* reports.

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20. The second concern regarding the passage of time since I submitted testimony in New Jersey is that, in the intervening months, the Court issued *USTA II*, and the FCC issued the instant *NPRM*. As discussed above, these major regulatory decisions are motivating CLECs' re-assessments of their business plans, which, in turn, will lead to changes in data about CLECs' presence in particular markets. The FCC's next release of local competition data (in December 2004 for data effective through June 30, 2004) may incorporate some of this effect. However, in my view, these regulatory events will only further dampen local competition, and, for this reason, do not alter my assessment that mass market switching impairment exists throughout New Jersey. If, however, the FCC considers it essential to review data that post-dates at least the *USTA II* decision, this data-gathering route would further justify the FCC holding evidentiary hearings to allow all parties comparable access to data.

21. Until recent data are made available, I cannot fully assess the impact of *USTA II* on CLECs' deployment decisions. ILECs are quick to assert that the availability of UNE-P (at prices they contend are too low) discourages CLECs from deploying their own switches. For example, in Utah's impairment proceeding, a Qwest witness stated that "[u]nnecessary unbundling requirements reduce the incentives of entrants and incumbents alike to invest and innovate." The witness further asserted:

If UNE-P resale is available in markets where it is not necessary for entry, carriers will have a strong incentive to avoid the risk of investing in their own networks to compete against each other. Incumbents will similarly be less inclined to invest and

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innovate if the benefits of their doing so will be reaped (cheaply) by their competitors.²³

An alternative view, to which I ascribe, is that the availability of UNE-P, set at cost-based rates, provides accurate pricing signals, which in turn leads to economically efficient investment and avoids wasteful duplication of resources.²⁴ If, contrary to my belief, ILECs are correct, then one would expect, in the wake of the sobering Court decision, a surge of CLEC interest in deploying UNE loops. If, on the other hand, we observe a decline in UNE-P demand without an offsetting increase in UNE loops, the ILECs' assertion that UNE-P is a "crutch" will lose even more credibility. In this instance, consumers will be harmed because UNE-P – as both a stepping stone and alternative to facilities-based competition – will not be able to realize its potential as a catalyst in offering residential and small business customers choice among suppliers. Instead of migrating from UNE-P to UNE-L (or to entirely facilities-based deployment), CLECs may exit the mass market entirely. Furthermore, unless and until ILECs provide empirical evidence demonstrating that CLECs use UNE loops to serve *residential* customers, *the loss of UNE-P disproportionately harms residential customers.*

²³Direct testimony of William Fitzsimmons on behalf of Qwest Corporation, January 13, 2004, Utah Public Service Commission Docket No. 03-999-04, at 15.

²⁴A recent study shows that "states that have established relatively lower rates for unbundled loop access have enjoyed *more* consumer choice and have seen *more* deployment of broadband technology within their borders." "The Positive Effects of Unbundling on Broadband Deployment," Phoenix Center Policy Paper No. 19, George S. Ford and Lawrence J. Spiwak, Phoenix Center Policy Center, September 2004, at 12 (emphasis in original).

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Several economic and public policy principles should guide the FCC's establishment of network unbundling rules and its application of those rules to particular markets.

22. In its establishment of final network unbundling rules and in its application of those rules to granular evidence about specific local markets, the FCC should adhere to several important economic and public policy principles:

- *Further the goals of the 1996 Act:* Ultimately, the litmus test of whether the final rules are sound is whether they further the goals that Congress set forth in the Act.
- *Issue rules that further congressional goals and the FCC's objectives, as informed by the states:* Because the FCC is now issuing new rules, in those instances where it may disagree with the substantive arguments in the *USTA II* decision (as opposed to the unlawful delegation of authority to states), the FCC can set rules that incorporate the agency's administrative expertise, and that may not conform to the policy issues precisely as the Court frames them.
- *Stability/Minimize consumer disruption:* As the FCC stated in its *NPRM*,²⁵ it is important to avoid unnecessary instability and consumer disruption. Absent compelling reasons to the contrary, the rules that the FCC adopts in this rulemaking should promote investor confidence in CLECs' operations and consumer confidence in the viability and longevity of competitive choice in the local telecommunications market.

²⁵*NPRM*, ¶¶ 1, 10, 20.

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- *Consistency with existing law and rules:* The FCC's final rules should be compatible with other telecommunications laws and rules, e.g., Section 271 requirements; state purview over intrastate rates, etc.
- *Consistency with USTA II:* The recommendations, set forth in this Affidavit, are consistent with the directives set forth in *USTA II* and are intended to address the specific failings that the Court identified with the FCC's August 2003 *TRO*.
- *Further the goal of economically efficient local competition:* the FCC should establish UNE rules that encourage the economically efficient deployment of facilities by incumbent and new carriers. Although state or federal regulators should not "pre-select" any particular mode of entry (Congress did not favor any particular mode), assuming, *arguendo*, that the FCC nonetheless chooses to promote facilities-based competition,²⁶ UNE-P is entirely compatible with such a goal.

²⁶*Id.*, ¶ 2

III. RELEVANT MARKETS

It is essential that the FCC correctly define the relevant markets before it applies its unbundling framework.

23. The FCC seeks comment on “how best to define relevant markets (*e.g.*, product markets, geographic markets, customer classes) to develop rules that account for market variability and to conduct the service-specific inquiries to which *USTA II* refers.”²⁷ The *Triennial Review NPRM*, incorporated by the FCC into the instant *NPRM*, also seeks comment on how best to define markets.²⁸

24. In its *NPRM*, the FCC states that the *USTA II* decision requires that it “must account for specific characteristics of the market in which a particular requesting carrier operates” when undertaking its impairment analysis.²⁹ The D.C. Circuit Court of Appeals found in *USTA II* that “the FCC is obligated to establish unbundling criteria that are at least aimed at tracking relevant market characteristics and capturing significant variation.”³⁰ This follows the Court’s objection

²⁷*Id.*, ¶ 9.

²⁸*Id.*, ¶ 11, footnote 39; *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Notice of Proposed Rulemaking, 16 FCC Rcd 22781 (2001) (“*Triennial Review NPRM*”), ¶¶ 39, 43, 57-58.

²⁹*NPRM*, ¶ 9, footnote 35.

³⁰*USTA II*, at 9.

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expressed in *USTA I*, to the FCC's issuance of "broad" unbundling rules that apply across all geographic markets and customer classes "without regard to the state of competitive impairment in any particular market."³¹

25. The proper definition of relevant markets is essential for the purpose of assessing whether impairment exists. Relevant markets include product markets (*i.e.*, mass market vs. enterprise market), geographic market (*i.e.*, the physical boundaries), and customer class (*i.e.*, residential vs. business). The FCC cannot undertake an analysis of impairment in the telecommunications market until and unless these markets have been properly defined. If the FCC were to define markets in such a broad manner that a finding of non-impairment was inevitable in most cases, customers would, in fact, *not* have substitutes for ILECs' services in some sub-markets. This would have grave consequences for consumers. If, instead, the FCC properly defined markets, and then identifies markets where impairment does exist, then properly applied unbundling rules will enable nascent competition to take hold.

The delineation between the mass market and the enterprise market should correspond with 24 DSO channels.

26. The FCC addresses the characteristics of the mass market in various portions of the *Triennial Review Order*. Among other things, it states:

Based on the record before us, it is reasonable to distinguish these three classes of customers - mass market, small and medium enterprise, and large

³¹*Id.*, citing *USTA I*, 290 F.3d, at 422.

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enterprise - for several reasons. These classes can differ significantly based on the services purchased, the costs of providing service, and the revenues generated. Because of these differences, for certain network elements the determination whether impairment exists may differ depending upon the customer class a competing carrier seeks to serve.³²

Mass market customers consist of residential customers and very small business customers. Mass market customers typically purchase ordinary switched voice service (Plain Old Telephone Service or POTS) and a few vertical features. Some customers also purchase additional lines and/or high speed data services. Although the cost of serving each customer is low relative to the other customer classes, the low levels of revenue that customers tend to generate create tight profit margins in serving them. The tight profit margins, and the price sensitivity of these customers, force service providers to keep per customer costs at a minimum. Profits in serving these customers are very sensitive to administrative, marketing, advertising, and customer care costs. These customers usually resist signing term contracts.³³

Small and medium enterprises are willing to pay higher prices for telecommunications services than the mass market. Indeed, they are often required to do so under business tariffs. Because their ability to do business may depend on their telecommunications networks, they are typically very sensitive to reliability and quality of service issues. These customers buy larger packages of services than do mass market customers, and are willing to sign term contracts. These packages may include POTS, data, call routing, and customized billing, among other services. Although serving these customers is more costly than mass market customers, the facts that enterprise customers generate higher revenues, and are more sensitive to the quality of service, generally allow for higher profit margins. The higher profit margins and greater emphasis on quality of service can provide a greater incentive to competing carriers to provision their own facilities, and

³²*TRO*, ¶ 124.

³³*Id.*, ¶ 127, footnote omitted.

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the higher revenues make it easier to cover the fixed costs of installing such facilities.³⁴

27. The FCC could differentiate between the mass market and the enterprise market using three possible benchmarks. First, the FCC could rely on the definition that telecommunications carriers use in reporting local competition data to the FCC, which defines mass market as three or fewer lines to a location. Second, the FCC could use a price-based distinction, recognizing that at some “cross over” point, it is less costly for a consumer to order a DS1 line than to order multiple voice grade lines to a particular location. Finally, the FCC could simply determine that lines provisioned at a DS0 level are mass market lines, and lines provisioned at DS1 and above are enterprise market lines.

28. I recommend that for the purpose of differentiating between the mass market and the enterprise market the FCC adopt the last method in its network unbundling rules, *i.e.*, where CLECs are deploying DS0-level lines (whether they are deploying 1 or 23 to a customer), customers are considered to be mass market customers. Customers’ choice to purchase DS0 lines rather than DS1 lines reflects information about the price and their assessment of the appropriate cross over between the two products. However, as with mass market customers, I recommend that the FCC in its determination in the instant proceeding assess whether CLECs are serving the entire business market, or only a segment of the market. If, for example, CLECs are only serving

³⁴*Id.*, ¶ 128.

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customers with four or more lines, then they should not be considered to constitute direct competition to the ILECs' services.

29. Although reliance on the "economic" cross over point for delineating between the mass and enterprise markets has theoretical appeal, such a determination depends on many variables (*e.g.* DSO and DS1 rates, DS1 multiplexing equipment costs, etc.), which, in turn, are subject to change. The four line carve-out previously set out by the FCC is one example. As the FCC noted in the *Triennial Review Order*, "[a]t some point, customers taking a sufficient number of multiple DS0 loops could be served in a manner similar to that described above for enterprise customers . . . this cross over point may be the point where it makes economic sense for a multi-line customer to be served via a DS1 loop."³⁵ The FCC opines that the "cross over" point may correspond with the four line carve-out in density zone 1 of the top 50 Metropolitan Statistical Areas ("MSA").³⁶

30. As described in Section IV below, Verizon NJ initially proposed that the cross over between mass market and enterprise customers should be determined by whether customers are being served with voice grade DS0 circuits or DS1 loops. However, contrary to Verizon NJ's position in its December 2003 filing with the New Jersey Board, Verizon NJ now seeks to implement the four line carve out, as described in the *UNE Remand Order*.³⁷ Verizon NJ notified

³⁵*Id.*, ¶ 497.

³⁶*Id.*

³⁷*In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, FCC CC Docket No. 96-98, Third Report and Order and

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several CLECs on May 18, 2004, that, effective August 22, 2004, it would no longer provide “unbundled local circuit switching subject to the Four Lines Carve-Out Rule, whether alone or in combination with any other network element” and “unbundled shared transport for use with unbundled local circuit switching subject to the Four Lines Carve-Out Rule.”³⁸ In its attempt to implement the four line carve-out *before* the FCC has ruled on the appropriate distinction between mass market and enterprise customers, Verizon NJ is apparently seeking to obtain at least partial “relief” for a subset of customers within its broader proposed non-impairment markets.

31. Verizon NJ’s decision, at this time of regulatory uncertainty, to seek to discontinue access to unbundled local circuit switching under the guise of the four line carve-out is incredible. The FCC extended the four line carve-out in the TRO “on an interim basis” pending regulatory decisions “to avoid service disruptions that may result from expanding and then possibly reducing

Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696 (1996) (“UNE Remand Order”). *See*, in particular, ¶¶ 276-298. The FCC found that “requesting carriers are not impaired without access to unbundled local circuit switching when they serve customers with four or more lines in density zone 1 in the top 50 [MSAs] . . . where incumbent LECs have provided nondiscriminatory, cost-based access to the enhanced extended link (EEL) throughout density zone 1.” *Id.*, at ¶ 278. It appears that the EEL requirement is no longer applicable. *See*, TRO, ¶ 525, footnote 1608.

³⁸Letter from Jeffrey A. Masoner, Vice President, Interconnection Services Policy and Planning, Wholesale Marketing (Verizon) to Corey Rinker (Trucom Corporation d/b/a BridgeCom International Inc.), “Notice of Discontinuation of Unbundled Network Elements,” May 18, 2004, provided as “Exhibit 1” to letter from Charles C. Hunter, Vice President and General Counsel, BridgeCom International Inc., TruCom Corporation to Kristi Izzo, Secretary, New Jersey Board of Public Utilities, BPU Docket No. TO03090705, dated August 26, 2004.

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the eligibility for local circuit switching in this manner.”³⁹ The FCC’s intent was to retain the *status quo*. Instead, Verizon NJ is attempting to force CLECs to migrate their *existing* customers or to pay Verizon NJ a surcharge equal to the resale rate for these lines (in addition to the application of UNE-P rates for the lines).⁴⁰

32. Not surprisingly, the New Jersey Board ordered Verizon NJ to continue providing access to unbundled local circuit switching for a minimum of 90 days from the Court’s mandate and reserved the right to “determine whether and how to exercise further review of proposed changes to interconnection agreements in accordance with its Standstill Order and relevant interim FCC rules, said review to include, but not be limited to, establishment of the appropriate demarcation point for the determination of mass-market customers.”⁴¹

33. The Board recognized correctly that the legal landscape pertaining to mass market switching is highly uncertain at this time. The FCC had delegated to the states the responsibility to determine whether the four line carve-out had been in effect in their respective states and to

³⁹*TRO*, ¶ 525.

⁴⁰Letter from Jeffrey A. Masoner, Vice President, Interconnection Services Policy and Planning, Wholesale Marketing, Verizon, to Corey Rinker, Trucom Corporation d/b/a BridgeCom International Inc., subject: “Notice of Discontinuation of Unbundled Network Elements,” May 18, 2004, at 2.

⁴¹*In the Matter of the Implementation of the Federal Communications Commission’s Triennial Review Order*, New Jersey Board of Public Utilities Docket No. TO03090705, Order on Motion for Clarification, August 19, 2004 (“BPU Carve-Out Order”), at 11.

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determine “the appropriate cut-off for multi-line DS0 customers.”⁴² *USTA II* vacated the nationwide finding of impairment and the delegation of the analysis of impairment to the states. As such, the Board determined that the four line carve-out was never implemented in New Jersey and that Verizon NJ’s use of the carve-out, at this time, “undermines the FCC’s rationale underlying” its extension of the four line carve-out on an interim basis.⁴³

34. As the Board and the FCC have both acknowledged, the four line carve-out should be re-examined in the context of the entire unbundling framework being contemplated at this time.⁴⁴ As such, the FCC still needs to make a market-specific determination with respect to the demarcation point between mass market and enterprise customers. I urge the Commission to refrain from adopting the four line carve-out on a permanent basis.⁴⁵ As the FCC recognized in the *TRO*, the four line carve-out has been implemented in just a few areas of the country.⁴⁶

35. The FCC, in its *Triennial Review NPRM*, expresses some concerns with the four line carve-out. Specifically, while the FCC selected the top fifty MSAs for inclusion because switch

⁴²*TRO*, ¶ 525.

⁴³*BPU Carve-Out Order*, at 10.

⁴⁴*Id.*; *TRO*, ¶ 525; The *Triennial Review NPRM* seeks comment on whether a “substantially revised approach [to the four line carve-out] is called for.” *Triennial Review NPRM*, ¶ 56.

⁴⁵See *TRO*, ¶ 497, footnote 1546.

⁴⁶*Id.*, footnote 1545.

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deployment appeared to be concentrated in these areas (*i.e.*, at least three switches in most MSAs), the deployment of switches is not a good proxy for evaluating the level of mass market competition, *i.e.*, where customers are actually served throughout a relevant market.⁴⁷ In addition, a line-count approach appears to be difficult to implement for specific end-users, who may grow, or expand and contract on a seasonal basis.⁴⁸

36. As Attachment SMB-2 shows, Verizon NJ seeks to implement the “carve-out” in 24 wire centers in New Jersey, 23 of which are within Verizon NJ’s proposed non-impairment market. Verizon NJ’s position that CLECs are not impaired in these geographic markets, a position which the Ratepayer Advocate and other parties challenged in New Jersey Docket No. TO03090705, does not justify its unilateral attempt to cease providing unbundled switching *before* the FCC has ruled on either (1) the appropriate distinction between mass market and enterprise customers, or (2) whether CLECs are no longer impaired in any particular geographic market. Although Verizon NJ is eager to cut off unbundled switching for these customers because it asserts that CLECs are not impaired in these markets, the granular analysis proves otherwise. *A detailed analysis of New Jersey-specific data indicates that the four line carve-out improperly makes a determination of non-impairment for markets where CLECs are actually still impaired.* I recommend that the FCC recognize mass market customers as those for which CLECs deploy DSO-level lines. The FCC

⁴⁷*Triennial Review NPRM*, ¶ 57.

⁴⁸*Id.*, ¶ 59.

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should not maintain the four line carve-out rule, but rather should further define the geographic market for which impairment should be determined as described below.

The unbundling framework should be applied at the wire center level, which is the appropriate geographic market to use in assessing impairment.

37. The *Triennial Review NPRM* seeks comment on how to take geography into account in the FCC's unbundling analysis and what kinds of "geographic delineations would be useful" to such an analysis.⁴⁹ The FCC notes that "a service- or location-specific analysis will be administratively more difficult, because it will involve more data and more review" and asks how it should "weigh the benefits of more refined unbundling rules against the administrative burden of conducting the more detailed analysis and applying more complicated rules."⁵⁰

38. In its *Triennial Review Order*, the FCC specifically deferred to states' ability to determine the appropriate level of granularity for assessing whether CLECs would be impaired without access to ILECs' switching elements. The FCC must once again make these determinations, given the Court's decision in *USTA II*. However, the FCC should be guided by the Court's findings in *USTA II*, and, as such, must adopt unbundling rules that take into account varying geographic markets and customer classes.⁵¹ While it may be tempting to opt for administrative simplicity, the

⁴⁹*Id.*, ¶ 39.

⁵⁰*Id.*, ¶ 40

⁵¹*USTA II*, at 9.

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FCC has been barred from adopting broad unbundling rules for the sake of easing administrative burdens. It is imperative that the FCC define the geographic market before it can proceed with its own impairment analysis and application of an unbundling framework.

39. The manner in which the geographic market is defined is critical to the outcome of this proceeding. By way of illustration, were the FCC to define entire states as markets (an option that the FCC prohibited in the *TRO*), and one CLEC were to be self-provisioning in Atlantic City, another CLEC in Newark, and a third in Trenton, one might argue that the FCC-established self-provisioned trigger would be met for all consumers throughout the state. Clearly this approach (which no one is advocating) would be an economically indefensible outcome because consumers in Newark cannot substitute services that a CLEC offers in Trenton. At the other end of the spectrum, if the FCC were to establish a census block group (“CBG”) as the relevant market for examination, the presence of a CLEC in one CBG would have no bearing on the FCC’s findings in the neighboring CBG, and the analysis would be excessively narrow. Improperly defined geographic markets will mean that CLECs will not be able to serve the mass market using UNE-P, and, therefore, may not be able to serve the mass market at all.

40. The goal in this proceeding should be to designate markets that conform to:

- The actual development of competition;
- The structure of the local market;
- The pricing and regulatory history within the state; and
- Administrative feasibility.

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41. While recognizing that the *USTA II* decision found that the FCC's delegation to the states was unlawful, the framework outlined by the FCC in its *TRO* is still applicable to the analysis of impairment now before the FCC. Rule 51.319 states:

A state commission shall define the markets in which it will evaluate impairment by determining the relevant geographic market to include in each market. In defining markets, a state commission shall take into consideration the locations of mass market customers actually being served (if any) by competitors, the variation in factors affecting competitors' ability to serve each group of customers, and competitors' ability to target and serve specific markets profitably and efficiently using currently available technologies. A state commission shall not define the relevant geographic area as the entire state.⁵²

42. In the *TRO*, the FCC states, in pertinent part:

The triggers and analysis described below must be applied on a granular basis to each identifiable market. State commissions must first define the markets in which they will evaluate impairment by determining the relevant geographic area to include in each market. State commissions have discretion to determine the contours of each market, but they may not define the market as encompassing the entire state. Rather, state commissions must define each market on a granular level, *and in doing so they must take into consideration the locations of customers actually being served (if any) by competitors*, the variation in factors affecting competitors' ability to serve each group of customers, and competitors' ability to target and serve specific markets economically and efficiently using currently available technologies. While a more granular analysis is generally preferable, states should not define the market so narrowly that a competitor serving that market alone would not be able to take advantage of available scale and scope economies from serving a

⁵²§51.319(d)(2)(i).

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wider market. State commissions should consider how competitors' ability to use self-provisioned switches or switches provided by a third-party wholesaler to serve various groups of customers varies geographically and should attempt to distinguish among markets where different findings of impairment are likely. The state commission must use the same market definitions for all of its analysis.⁵³

The FCC should, in the case before it now, follow similar reasoning.

43. The overriding criterion in determining the geographic market should be whether customers are actually being served.⁵⁴ To that end, I recommend that the FCC adopt the wire center. The wire center is logical, corresponds with the economics of the supply and the demand for retail and wholesale services, is administratively feasible, and recognizes disparate customer densities. By contrast, Verizon NJ's proposed geographic market definition in the Commission-mandated state proceeding, and that of other ILECs, is artificial and encompasses wire centers with differing structural attributes.

44. Much of the germane information about local market structure is based on the ILECs' wire centers. Among the various relevant factors that correspond with wire centers, in the case of the data I analyzed in New Jersey, are the following:

⁵³*TRO*, ¶ 495, footnotes omitted, emphasis added.

⁵⁴*Id.*, ¶ 495.

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- Verizon NJ's prices charged to the end user (*i.e.*, the retail price against which new entrants must compete, which, in turn, affects their potential revenues).⁵⁵
- Verizon NJ's prices charged to CLECs for UNEs (*i.e.*, the wholesale price new entrants must pay for essential elements, which, in turn, affects their costs).⁵⁶
- The area served by wire centers varies in size and topography, with significantly diverse cost characteristics.⁵⁷
- Availability of collocation space.⁵⁸

45. Although the FCC identifies size as a relevant criterion for determining relevant markets, Verizon NJ not provide information regarding the square mileage of its wire centers (one of the factors the FCC identifies as a possible criterion for determining geographic markets) stating that "it does not have the requested information."⁵⁹ This information would permit an assessment of

⁵⁵Verizon NJ charges four different local exchange service rates. The rate for any given wire center depends on its classification among the four exchange groups. Bell Atlantic - New Jersey, Inc., Tariff B.P.U. - N.J. - No. 2, Exchange and Network Services, 8th revised page 30, 7th revised page 31, 6th revised page 32, 7th revised page 33, 8th revised page 34, 7th revised page 35.

⁵⁶Verizon NJ's local UNE loop rates vary among three density zones. Wholesale Loop Costs, *Summary Order of Approval*, New Jersey Board of Public Utilities Docket No. TO00060356, December 17, 2001, Attachment A.

⁵⁷The FCC appropriately identifies the size of the wire center as a potential factor to use in defining geographic markets. *TRO*, ¶ 496.

⁵⁸The FCC specifically identifies "variations in the capabilities of wire centers to provide adequate collocation space" as a relevant factor for defining geographic markets. *Id.*

⁵⁹Verizon NJ Response to RPA-TRO-93(g).

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line density, which, in turn, affects the cost of supplying basic local exchange telecommunications services.

46. Although economic theory relies, in part, on the presence of price discrimination to define markets,⁶⁰ in the state filings I examined, the ILECs did not address the fact that their proposed geographic markets encompassed retail and wholesale prices, which vary based upon the wire center. For instance, in the case of Verizon NJ, the range of rates within the Newark and Camden MSAs is further evidence of the excessively broad nature of Verizon NJ's proposed geographic market. Verizon NJ's proposed market includes locations classified in Exchange Group B (*e.g.*, Asbury Park and Fort Dix), Exchange Group C (*e.g.*, Cliffside and Perth Amboy), and Exchange Group D (*e.g.*, Hackensack and Newark).⁶¹ Similarly, wholesale UNE loop rates within Verizon NJ's market areas vary among three density zones. This hodgepodge of wholesale and retail rates (factors which critically affect the profitability of local entry) within the Newark and Camden MSAs demonstrates that Verizon NJ's proposed markets are not based on economic principles.

47. In their *Horizontal Merger Guidelines*, the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") define a market "as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm,

⁶⁰Horizontal Merger Guidelines, Department of Justice and the Federal Trade Commission, issued April 2, 1992, revised April 7, 1997 ("Horizontal Merger Guidelines"), § 1.12.

⁶¹Bell Atlantic - New Jersey, Inc. Tariff B.P.U. - No. 2, Exchange and Network Services, 7th revised page 31, original page 32.1, and 8th revised page 34.

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not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a ‘small but significant and nontransitory’ increase in price, assuming the terms of sale of all other products are held constant.” The DOJ and FTC explain further that a “relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test.”⁶²

48. The purpose of this nationwide exercise is to create choice for *customers*, and, therefore, the focus should be on whether customers are *actually* being served. If markets are defined too broadly, they will encompass wire center areas where CLECs may not actually be serving customers in the proposed geographic market. Viewed from the customer’s perspective, the fact that a CLEC is serving customers in an adjacent wire center, responding, perhaps in part, to the prevailing (*i.e.*, ILEC) market price, does not translate into competitive choice for the customer in the home exchange, where the CLEC may not have yet raised the capital to install facilities, and/or the prevailing market price is less (thus diminishing revenue opportunities and dampening CLEC interest). If the FCC, contrary to my recommendation, adopts broader markets than the wire center, then the FCC should only consider those CLECs that serve the entire market, not just a portion of the area, as relevant competitors in the mass market.

49. An illustration from New Jersey makes this point. A customer who resides in Bergen County cannot substitute the local service offered by a CLEC in Monmouth County. As I

⁶²*Horizontal Merger Guidelines*, § 1.0.

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demonstrate in Section IV below, the evidence shows that CLECs compete on a wire center basis, and the mere fact that a CLEC serves a particular wire center does not imply that it serves all 81 zone 1 and zone 2 wire centers in the Newark MSA nor that it serves all fifteen zone 1 and zone 2 wire centers in the Camden MSA. An excessively broad market masks important structural differences within the area.

50. The FCC does caution states in the *TRO* to “not define the market so narrowly that a competitor serving that market alone would not be able to take advantage of available scale and scope economies from serving a wider market.”⁶³ One solution may be to cluster contiguous wire centers that have similar market characteristics. However, although clustering of wire centers has a theoretical appeal, it would not be administratively practical for the FCC, particularly within the limited time frame contemplated for this proceeding, to cluster wire centers accurately.

51. As discussed in Section IV below, Verizon NJ proposed the use of MSAs to define geographic markets for the purpose of the FCC’s impairment analysis. Indeed at least three RBOCs (Verizon, SBC and Qwest) all proposed the use of MSAs in their state filings.⁶⁴ The

⁶³*TRO*, ¶ 495.

⁶⁴See, e.g., *In the Matter of Proceeding to Address Actions Necessary to Respond to the Federal Communications Commission Triennial Review Order Released August 21, 2003*, Utah Public Service Commission Docket No. 03-999-04, Direct Testimony of William Fitzsimmons on behalf of Qwest Corporation, January 13, 2004, at iv; *In the Matter of the Implementation of the Impairment Review Mandated by the Federal Communications Commission in its Triennial UNE Review*, Arkansas Public Service Commission Docket No. 03-171-U, Direct Testimony of Jon R. Loehman on behalf of SBC Arkansas Regarding Mass Market Switching, February 10,

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proposal to utilize MSAs as the geographic market over which to apply the FCC's unbundling rules has been vague and unsupported by witnesses in the state proceedings. For instance, the New Jersey Ratepayer Advocate propounded several discovery requests seeking the basis on which one of Verizon NJ's witnesses concluded that CLECs will seek to serve customers *throughout* an MSA. The responses indicated that his conclusion was based on general economic theory and that, in fact, CLECs may not seek to serve all portions of the market (*i.e.*, MSA).⁶⁵

52. As discussed in Section IV below, my review of the granular data in New Jersey suggests that there is substantial disparity among wire centers within MSAs in terms of switch deployment and UNE loop activity. Several CLECs may enter one wire center, while choosing not to offer service in another wire center that is within the same MSA. This market behavior would indicate that the CLECs view certain wire centers as being ones that are economic to enter and do make distinctions *on a wire center-basis*. The observed behavior suggests that the ILECs' proposed geographic market boundaries are woefully unsupported and inadequate for the purpose of applying the FCC's unbundling analysis. In its *Triennial Review Order*, the FCC addresses such a circumstance, concluding that "if competitors with their own switches are only serving certain geographic areas, the state commission should consider establishing those areas to constitute separate markets."⁶⁶

2004. Qwest supported the Arkansas PSC's decision to use LATAs, but proposed MSAs as an alternative geographic market. *Id.*, at 26.

⁶⁵Verizon NJ's responses to RPA-TRO-132 through RPA-TRO-137.

⁶⁶*TRO*, ¶ 496, footnote 1537.

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53. Certainly the ILECs have failed to demonstrate that their proposed “mega-clusters” (*i.e.*, MSAs) correspond with the underlying scale and scope economies that CLECs may have. Where a theoretical concept cannot be supported by a detailed economic assessment, its practical implementation may well harm the development of competition, and therefore consumers. For example, simply because switching equipment *can* serve broad geographic areas, this does not mean the economies of scale and scope justify *actually* serving customers in the broader area. It is critical for the FCC to examine where customers are *actually* being served. CLECs may be able to recover the associated additional collocation and transport costs of serving a large geographic area over only a very small number of customers, thus not justifying the additional expense. The fact that network architecture can support broad deployment is only one relevant factor; more important is whether broadening its market is financially prudent for the CLEC.

54. The market definition that the FCC establishes in this proceeding has long-term implications for local competition in New Jersey and across the nation. It is important to define the market appropriately because the market boundary that the FCC determines in this proceeding will likely serve as the foundation for future ILEC requests for findings of non-impairment (or similar filings related to network unbundling rules). Therefore, even if, when viewed on an excessively broad area, such as a MSA, the ILECs do not provide evidence of non-impairment at this time, the FCC should not adopt their ill-supported use of the MSA as the relevant geographic market. Separate from the assessment of impairment, the FCC should determine the market boundaries that are best suited for the supply, demand, and consumer features of the local telecommunications mass

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market.⁶⁷ Drawing an excessively broad market presumes an efficiency and intent to serve that may not actually exist.

CLECs are impaired in a given geographic market unless and until CLECs serve residential *and* business customers.

55. CLECs must serve both residential *and* business customers to be considered to be serving the entire mass market. The FCC ordered in the *TRO*, that, “[i]n circumstances where switch providers (or the resellers that rely on them) are identified as currently serving, or capable of serving, only part of the market, the state commission may choose to consider defining that portion of the market as a separate market for purposes of its analysis.”⁶⁸ There is no evidence that the reasoning behind that guidance is not sound and the FCC should continue to be guided by its analysis in the *TRO* regarding the distinctions in customer class within the mass market. The residential and small business markets differ for several reasons, which means that, for the purpose of analysis, the FCC should consider separately whether the relevant sub-markets are actually served by self-provisioning CLECs. It is essential to examine whether mass market customers are being served in both sub-markets, including the residential sub-market and the small business sub-market.

⁶⁷Furthermore, in my view, the FCC could more easily *expand* than *contract* the geographic market at a future date, based on more detailed evidence.

⁶⁸*TRO*, footnote 1552. The *TRO Errata* does not change the wording of this footnote, although it does change the sentence to which this footnote refers, i.e., the sixth sentence.

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56. The residential market is clearly a distinct customer class within the mass market. ILECs charge different rates for residential and business local exchange service, as the New Jersey data shown in Attachment SMB-3 demonstrate. The ability to price discriminate is evidence of separate markets.

57. The fact that a CLEC has deployed a switch that serves a sub-market, e.g., only small business customers, does not indicate that it will expand its offerings to serve residential customers. The focus should be whether CLECs are *actually* serving customers, not whether they have the potential to do so. It comes down to the observation that if CLECs found it profitable to serve the residential market, they would be doing so. CLECs that are physically able to serve residential customers in a wire centers where they have already deployed a switch have chosen to serve only the business market. There are clearly financial reasons for such a decision.

58. The FCC stated in the *TRO* that “[m]ass market customers are analog voice customers that purchase only a limited number of POTS [plain old telephone service] lines, and can only be economically served via DS0 loops.”⁶⁹ CLECs must be serving the entire analog voice mass market. If a CLEC is serving only one class of customers, and not the other, then the CLEC should not count toward the application of the self-provisioning trigger. For this reason, in analyzing the data that CLECs provided in the New Jersey proceeding, I distinguish between instances where

⁶⁹*TRO*, ¶ 497.

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CLECs serve residential and business customers to enable the FCC to assess whether CLECs are serving the entire mass market.⁷⁰

⁷⁰See Section IV of my Affidavit.

IV. GRANULAR DATA IN NEW JERSEY'S LOCAL MARKETS

Introduction

59. This section of the Affidavit (1) briefly summarizes Verizon NJ's mass market filing; (2) describes the granular data submitted in New Jersey's impairment proceeding; and (3) summarizes the results of my data analysis. Information about New Jersey's local markets is essential to an assessment of whether impairment exists because, as the FCC has stated, "[b]ased on our experience from prior proceedings, we anticipate that we will find evidence of actual marketplace conditions to be more probative than other kinds of evidence, such as cost studies or hypothetical modeling."⁷¹

Overview of Verizon NJ's mass market impairment filing

Verizon NJ's proposed geographic markets lack empirical justification.

60. Based on data in the Local Exchange Routing Guide ("LERG"),⁷² Verizon NJ stated that fourteen CLECs operate 27 local circuit switches located within New Jersey.⁷³ However, Verizon

⁷¹*Triennial Review NPRM*, ¶17.

⁷²The LERG is an industry-prepared data base with, among other things, geographic, rating, routing, and numbering data.

⁷³Direct Testimony of Harold E. West III and Carlo M. Peduto, II, filed December 3, 2003 ("West/Peduto"), New Jersey BPU Docket No. TO03090705, at 18. On January 16, 2004, Verizon NJ filed supplemental testimony. Supplemental Testimony of Harold E. West III and

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NJ apparently did not rely on this information, *per se*, in defining its proposed “relief” area,⁷⁴ but rather identified specific CLECs and the quantities of loops they serve using self-provisioned switches in support of its claim that the Board should find non-impairment in certain proposed geographic markets.⁷⁵

61. Verizon NJ proposed the use of MSAs and density zones, the former, because they “have well-established geographic boundaries” and “are specifically designed to capture economic communities of interest.”⁷⁶ Verizon NJ also referred to the FCC’s *Pricing Flexibility Order* in support of the use of MSAs.⁷⁷ Verizon NJ explained further that “the Board may choose to define the market more narrowly” and specifically suggested that the Board might differentiate among the pricing density zones within the relevant MSAs. According to Verizon NJ, density zones reflect where customers are actually served, competitors’ ability to serve each group of customers, and CLECs’ targeting of particular customers. Although Verizon NJ opposed the use of the wire center because it contended this geographic boundary would be “overly granular” and thus “ignore

John White (“West/White”).

⁷⁴As used in this Affidavit, “relief” area refers to the geographic area within which Verizon NJ sought a finding of non-impairment by the Board.

⁷⁵West/Peduto Direct (Verizon NJ), Attachment 2.

⁷⁶*Id.*, at 11.

⁷⁷*Id.*, at 11-12, citing *Access Charge Reform*, Fifth Report and Order and FNPRM, 14 FCC Rcd. 14,221 (August 27, 1999) (“Pricing Flexibility Order”).

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available scale and scope economies,”⁷⁸ Verizon NJ did not offer evidence in support of this assertion. As I discuss below, Verizon NJ has not demonstrated that its proposed geographic market is appropriate.

62. As defined by the Office of Management and Budget (“OMB”),

Metropolitan Statistical Areas have at least one urbanized area of 50,000 or more population, plus adjacent territory that has a high degree of social and economic integration with the core as measured by commuting ties. ... If the specified criteria are met, a Metropolitan Statistical Area containing a single core with a population of 2.5 million or more may be subdivided to form smaller groupings of counties referred to as Metropolitan Divisions.⁷⁹

Verizon NJ’s filing would affect the availability of unbundled switching in the New Jersey portions of the New York-Newark-Edison, NY-NJ-PA MSA (“Newark MSA”) and the Philadelphia-Camden-Wilmington, PA-NJ-DE-MD MSA (“Camden MSA”). The Newark MSA includes three Metropolitan Divisions: Edison, New Jersey; Newark-Union, NJ-PA; and New York-Wayne-White Plains NJ-NJ (part). The Camden MSA includes two Metropolitan Divisions: Camden and Wilmington, DE-MD-NJ (part).⁸⁰

⁷⁸*Id.*, at 13-15.

⁷⁹OMB Bulletin No. 03-04, Attachment, Statistical and Science Policy Branch, Office of Information and Regulatory Affairs, Office of Management and Budget, June 6, 2003 (“OMB Bulletin”), Attachment at 2.

⁸⁰*OMB Bulletin*, Attachment, at 117.

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63. Verizon NJ's proposal encompasses four geographic markets, which it depicted in a map included with its filing with the Board and which I have reproduced as Attachment SMB-4.⁸¹ Verizon NJ refused to specify the precise number of the geographic markets that it proposes.⁸² It appears that, if regulators were to adopt Verizon NJ's second recommendation (*i.e.*, the use of density zones within MSAs), Verizon NJ intended four distinct markets: density zone 1 and density zone 2 in each of the two relevant MSAs, the Newark and the Camden MSAs.⁸³ For sake of reference, these could be identified as follows:

- Zone 1 Newark MSA market;
- Zone 2 Newark MSA market;
- Zone 1 Camden MSA market; and
- Zone 2 Camden MSA market.

67. Verizon NJ's depiction of its proposed market boundaries in the map that it included with its impairment filing does not include the boundaries of the wire centers within the four proposed relief areas.⁸⁴ Verizon NJ was unwilling, in response to a data request propounded by the Ratepayer

⁸¹West/Peduto Direct (Verizon NJ), Attachment 3.

⁸²Verizon NJ response to RPA-TRO-91.

⁸³Verizon NJ response to RPA-TRO-92; West/Peduto Direct (Verizon NJ), Attachment 3.

⁸⁴West/Peduto Direct (Verizon NJ), Attachment 3 (reproduced as Attachment SMB-4 to this Affidavit).

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Advocate, to provided this level of granular market information.⁸⁵ Because Verizon NJ was unable or unwilling to provide this information, I superimposed municipal boundaries (using publicly available geographic data), which roughly approximate wire center boundaries, on the map that Verizon NJ submitted with its filing for a finding of non-impairment.⁸⁶

68. Wire center boundaries provide useful granular data, which contribute to an informed determination of the appropriate market boundaries and subsequently to an assessment of whether impairment exists within a particular geographic market. The map that I created (which combines information about Verizon NJ's proposed relief areas with information about municipal boundaries) provides a surrogate of this type of information. As an integral part of their impairment filings with the FCC, ILECs should identify the boundaries of their wire centers and proposed market areas in electronic format capable of being manipulated by geographic information systems ("GIS")⁸⁷ to enable the FCC first to assess whether ILECs' proposed boundaries correspond with rational economic markets, and then to evaluate whether and where impairment exists.

69. My examination of Verizon NJ's proposed market areas showed that its recommended boundaries are illogical. As Attachment SMB-6 shows, Verizon NJ's proposal would yield the

⁸⁵The data request and Verizon NJ's response (RPA-TRO-101) is reproduced as Attachment SMB-5.

⁸⁶The source of the geographic information is the New Jersey Department of Environmental Protection. See Attachments SMB-6 and SMB-7.

⁸⁷GIS is a computer system capable of storing, manipulating, and displaying data about geographic features and associated tabular data.

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unusual situation in which Kearny, which is a zone 2 area in the Newark MSA and which is entirely surrounded by a zone 1 area, would apparently nonetheless be considered as part of the rest of the non-contiguous zone 2 market (*i.e.*, the region including, among other locations, West Orange). Attachment SMB-6 also shows that Verizon NJ's proposed market would entirely surround, but not include, another location, namely the Zone 3 Oakland location.

70. Attachment SMB-7 shows that Verizon NJ's proposal would replicate an illogical result in the Camden MSA in a slightly different manner. There are two non-contiguous zone 2 markets that Verizon NJ apparently seeks to define as a single market (the Camden Zone 2 market), despite the fact that they are separated by "non-market" (*i.e.*, Density Zone 3) regions. Although Verizon NJ indicated that the Board could choose to use density zones, this alternative option that Verizon NJ depicts lacks any logical basis or empirical support. The geographic analysis shown in Attachments SMB-6 and SMB-7 is not intended to be exhaustive, but rather to provide the results of a detailed examination of a portion of Verizon NJ's market area.

Verizon NJ's proposed delineation between mass market and enterprise customers

71. Verizon NJ recommended that the cross over (or "cut off") between mass market and enterprise customers be determined by whether customers are being served with voice grade DS0 circuits or DS1 loops. In support of this recommendation, Verizon NJ observed that the "objective behavior of the CLEC" corresponds to what makes "economic sense" for the CLEC.⁸⁸ However, as I discuss in Section III above, contrary to Verizon NJ's assertion in its filing with the Board,

⁸⁸West/Peduto Direct (Verizon NJ), at 16.

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Verizon NJ now seeks to implement the four line carve-out, as described in the *UNE Remand Order*.⁸⁹

Data submitted by Verizon NJ regarding CLECs' presence in New Jersey

72. Verizon NJ used its internal databases to determine where and to which carriers Verizon NJ leases UNE loops, including enhanced extended links (“EELs”),⁹⁰ as of June 30, 2003 (the “Line Count Study”) and also used the E911 database to determine residential customers that carriers serve using their own loop facilities. Verizon NJ asserted that its Line Count Study underestimates CLEC presence because it does not include those CLECs that serve customers using their own switching and loop facilities, such as cable telephony providers.⁹¹ Verizon NJ summarized these data in Attachment 2 its testimony, and asserted that nine CLECs serve mass market customers in the Newark MSA and that five CLECs serve mass market customers in the Camden MSA, using self-provisioned switches. Based on this analysis, Verizon NJ asserted that the self-provisioning trigger is met in these markets.⁹²

⁸⁹*UNE Remand Order*, ¶¶ 276-298.

⁹⁰An EEL, which typically consists of an unbundled loop and interoffice transport, provides a way to connect a CLEC switch to customers at distant central offices.

⁹¹West/Peduto Direct (Verizon NJ), at 22.

⁹²*Id.*, at 27, 31. Although Verizon NJ considers Attachment 2 to its testimony to be proprietary, in its redacted testimony, Verizon NJ refers to the nine CLECs in the Newark MSA and to the five CLECs in the Camden MSA. *Id.*

Data examined by the Ratepayer Advocate, including data submitted by industry participants other than Verizon NJ

Background

73. In addition to examining the data that Verizon NJ included with its filing for relief in certain markets, I also examined two other broad categories of data. First, I examined the data and information that Verizon NJ provided in response to discovery propounded by the Ratepayer Advocate as well as by other parties.⁹³ Where I rely on these data in my analysis and findings in this Affidavit, I include the citations to these responses. Also, the Board's Staff and the Ratepayer Advocate propounded data requests to CLECs operating in New Jersey. Many CLECs responded that they did not provide local exchange services in New Jersey, and, therefore, I excluded them from my analysis. Although I examined the responses provided by numerous CLECs, I focused my efforts to obtain responses from those CLECs that Verizon NJ held out as providing evidence of non-impairment. Eventually, data responses were received to the Ratepayer Advocate's requests (albeit not complete in all instances) from the ten CLECs that Verizon NJ identified in Attachment 2 to its direct testimony. I rely on their responses to form my conclusions and recommendations.

74. Attachment SMB-8 to this Affidavit includes an excerpt of the data requests issued by the Ratepayer Advocate to CLECs. The excerpt includes those data requests that yielded the CLEC-provided data I consider most useful to my application of the FCC's trigger to New Jersey's local markets. CLECs submitted their responses during the fourth quarter of 2003. As RPA-TRO-16

⁹³The Ratepayer Advocate issued 159 data requests to Verizon NJ and CLECs in the Board's proceeding.

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indicates, the Ratepayer Advocate requested that CLECs provide up-to-date information as of January 15, 2004, but, with the Board's proceeding suspended, CLECs did not submit revised responses.

75. If the FCC determines that more up-to-date data are required to enable it to assess impairment, I recommend that it require Verizon NJ to submit a new impairment filing, based on recent data, and with information disaggregated to the wire center level. Within each wire center, Verizon NJ should provide information separately (in spreadsheet and printed format) as to its quantities of (a) residential customers; (b) residential lines; (c) businesses with one line; (d) businesses with two lines; (e) businesses with three lines, etc. The FCC should direct CLECs to provide comparable information. All carriers should be required to provide statewide totals for each of these categories.

76. Comprehensive granular data are essential to enable the FCC to consider whether the CLECs that Verizon NJ identifies in Attachment 2 to its direct case are "operationally ready and willing to provide service to all customers in the entire market, as that market is defined,"⁹⁴ and, in making that assessment, the readiness and willingness should be measured by whether CLECs *actually* serve customers. Furthermore, the FCC's stated intent that the competitive switch providers that are providing services only to a segment within the market should not be counted is

⁹⁴TRO, ¶ 500, footnote omitted.

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an important objective.⁹⁵ If a CLEC has self-provisioned a switch within a FCC-designated market, but only seeks to attract business customers (for example, the CLEC simply offers services that compete on price with the business market segment), then their offerings cannot be considered viable substitutes for the residential market. In this example, the CLEC is simply serving “a segment within the market,” and, therefore, the CLEC’s presence would not satisfy the self-provisioning trigger. Carriers that serve a few isolated and *de minimus* segments within the Newark and Camden MSAs are irrelevant to an impairment analysis.

77. I conducted a detailed analysis of the data that the industry submitted in response to various parties’ data requests and that Verizon NJ submitted in support of its filing (and its responses to data requests). I have included numerous attachments to this Affidavit, which summarize my analysis and which support my finding that, using economically appropriate markets, the FCC-established self-provisioning trigger is not met in New Jersey.

78. Many of the CLECs that Verizon NJ identified in its submission to the Board are irrelevant to the self-provisioning trigger. Verizon NJ relies on switch self-provisioning by CLECs that offer service in certain parts of New Jersey in support of its proposed finding of non-impairment.⁹⁶ However, a closer examination of these CLECs demonstrates that, for various reasons, not all of them should be relied upon by the Board for the purpose of making a finding of non-impairment.

⁹⁵*Id.* Specifically, the FCC states that requiring the trigger-related competitive switch providers to be “capable of serving the entire market” “prevents counting switch providers that provide services that are desirable only to a particular segment of the market.” *Id.*

⁹⁶West/Peduto Direct (Verizon NJ), Attachment 2.

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79. < < < **BEGIN PROPRIETARY**

END PROPRIETARY.> > >⁹⁷ SBC and Ameritech, when seeking regulatory approval for their merger applications, promised to enter local markets as “out-of-region” local competitors. By “out-of-region” I mean in an area where the company is not the ILEC, but rather is a new entrant seeking to compete with the incumbent carrier. SBC and Ameritech filed an application for approval of their merger with the FCC on July 27, 1998, and

⁹⁷Footnotes 97 through 106 are proprietary.

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promised, if the merger were approved, that SBC would enter 30 out-of-region markets throughout the country.¹⁰⁷ This obligation requires SBC to enter local markets in 30 cities, *not in 30 MSAs*.

80. SBC, a multi-billion dollar company, has vast resources. Furthermore, it has a century of experience offering local telecommunications service, substantial experience as an incumbent carrier negotiating interconnection agreements with CLECs (which it brings to the negotiating table when it negotiates interconnection agreements as a CLEC with Verizon NJ), has relevant technical expertise, and possesses substantial brand recognition. SBC has a unique and formidable ability to enter local markets in New Jersey.

81. The FCC transformed the carrier's *promises* to enter out-of-region markets as a CLEC into *regulatory conditions*.¹⁰⁸ The fact that SBC's entry into out-of-region local markets was among the *conditions* of the FCC's approval of the merger simply underscores the regulatory concern that, absent such an explicit requirement, SBC, despite its substantial size, resources, and expertise serving the local market, might have decided not to enter markets in New Jersey (and other out-of-region markets), once it had obtained the requisite regulatory approval to merge.

¹⁰⁷In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control, FCC CC Docket No. 98-141, *Application*, filed July 27, 1998, § II.A.1.

¹⁰⁸In re: Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control, FCC CC Docket No. 98-141, *Memorandum Opinion and Order*, released October 8, 1999 ("SBC/Ameritech Merger Order"), ¶¶ 398-399, Appendix E. The FCC's conditions require SBC to enter 30 of 50 potential out-of-region markets.

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82. A close examination of SBC's entry into New Jersey's local markets illustrates the complexities of analyzing the local market. The size of a company may affect that firm's ability to raise capital and to allocate resources to local entry, but in no way alters whether management perceives entry into a new market to be profitable, and thus worthy of active pursuit. CLECs' ability *and* willingness to enter and serve a market are both critical factors in an assessment of non-impairment.¹⁰⁹

83. Skepticism about SBC's planned entry into out-of-region market was expressed at the time of its proposed merger with Ameritech: "SBC's fiduciary responsibilities lie with its stockholders, not its customers, and if top management subsequently determines that out-of-region markets are not likely to become profitable within a reasonable period of time, SBC may well abort or scale back its National/Local strategy."¹¹⁰ Furthermore, one of SBC's own managers recognized that local entry might not be profitable. As was observed at the time the application was pending regulatory approval, "Mr. Kahan specifically states that the business plan for the National/Local

¹⁰⁹The FCC directs states to assess whether "customers [are] actually being served. *TRO*, ¶ 495.

¹¹⁰In re Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control, Federal Communications Commission CC Docket No. 98-141, Affidavit of Susan M. Baldwin and Helen E. Golding, on behalf of Indiana Utility Consumer Counselor, Michigan Attorney General, Missouri Public Counsel, Ohio Consumers' Counsel, Texas Public Utility Counsel and Utility Reform Network, filed on October 13, 1998, at ¶ 41.

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Strategy contemplates a ‘negative cash flow for nearly ten years.’”¹¹¹ Also, the following was observed: “The Applicants’ claims with respect to the benefits for residential and small business market are particularly unpersuasive. In fact, the Applications are openly disparaging of the residential and small business market.”¹¹²

84. If the local mass market is as open and attractive to competition as Verizon NJ apparently wishes regulators to believe, one would expect the data to support such a finding. Throughout the state of New Jersey, SBC serves <<< **BEGIN PROPRIETARY**

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END PROPRIETARY >>>¹¹⁴ Based on this <<< **BEGIN PROPRIETARY** **END PROPRIETARY** >>> entry and the fact that the entry that has occurred is a direct result of a regulatory obligation, I recommend that the Commission exclude SBC in its determination of whether the self-provisioning trigger is met in New Jersey markets. As I discuss in Section VI, if, contrary to my recommendation, the FCC includes SBC in the application of the network unbundling framework, I recommend that the FCC increase the required

¹¹¹*Id.*, at footnote 65, citing James S. Kahan (SBC), at ¶ 80.

¹¹²*Id.*, at ¶ 87.

¹¹³SBC response to RPA-TRO-3.

¹¹⁴SBC response to RPA-TRO-119.

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minimum of self-provisioning CLECs to four. In other words, if the FCC intends to apply the trigger in an excessively lenient fashion (*i.e.*, including CLECs with a negligible market presence), it is important to increase the number of CLECs that must be self-provisioning to demonstrate non-impairment.

85. Verizon NJ, in its direct case in New Jersey, referred to CLECs' switch deployment in two ways. First, on page 18 of Verizon NJ's direct testimony, Verizon NJ includes a table that summarizes the quantities of switches deployed by each CLEC in New Jersey according to the LERG. Second, and more significantly, in Attachment 2 to its testimony, Verizon NJ identifies those CLECs that it contends provide evidence that the FCC-established self-provisioning trigger is met within certain markets. I focused my analysis in particular on the CLECs encompassed in Attachment 2 to Verizon NJ's testimony because as I understand Verizon NJ's testimony, the earlier table is included solely to provide contextual information but does not, *per se*, shed light on whether the self-provisioning trigger is met in particular markets. Furthermore, I would note that several of the CLECs identified on page 18 of Verizon NJ's direct testimony do not offer voice grade telecommunications service.

86. I analyzed the CLECs that Verizon NJ contended provide evidence related to its claim of non-impairment.¹¹⁵ Verizon NJ contends that the switch deployment by ten CLECs provide evidence that the self-provisioning trigger is met, and specifically that in the Newark MSA, nine

¹¹⁵My analysis focuses on those CLECs that Verizon NJ identifies in its filing to the Board.

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CLECs self-provision switches and in the Camden MSA, five CLECs self-provision switches.¹¹⁶

According to Verizon NJ, the Board should find non-impairment in the wire centers that are classified in density zones 1 and 2 in these two MSAs.

Verizon NJ's proposal fails to consider significant market structure disparities within its proposed non-impairment boundaries.

87. Initially, Verizon NJ described the purported benefits of using MSAs, and then stated that the Board could choose to use density zones within the MSAs.¹¹⁷ The Newark and Camden MSAs include wire centers with density zone classifications of 1, 2, or 3.¹¹⁸ Under the “alternative” proposal, Verizon NJ seeks a finding of non-impairment only for those wire centers classified in density zones 1 and 2.¹¹⁹ Verizon NJ, however, fails to address or to provide any compelling evidence as to why it excludes zone 3 territory and why it contends there is no impairment in zones 1 and 2.

88. Attachment SMB-9 lists the 81 Verizon NJ-proposed non-impairment wire centers in the Newark MSA and the fifteen proposed non-impairment wire centers in the Camden MSA.

¹¹⁶West/Peduto Direct (Verizon NJ), at 26-27.

¹¹⁷*Id.*, at 11-14.

¹¹⁸Three density zones exist for pricing UNE loops in New Jersey. *Wholesale Loop Costs*, Summary Order of Approval, New Jersey Board of Public Utilities Docket No. TO00060356, December 17, 2001, Attachment A.

¹¹⁹Verizon NJ response to RPA-TRO-93.

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Confidential Attachment SMB-10 provides these data separately for the two MSAs by wire center and encompasses *all* the wire centers within the respective MSA boundaries, regardless of whether Verizon NJ considers them to be a “relief” area (*i.e.*, the attachment also includes the density zone 3 wire centers). Confidential Attachment SMB-10 also provides information about the quantities of retail and wholesale lines served, specifies the density zone, and provides other market structure data. I have grouped the wire centers in this exhibit by county to retain the geographic information that county boundaries provide. Attachment SMB-11 shows the county boundaries in New Jersey.¹²⁰

89. The portion of total lines that rely on UNE-P in the MSAs for which Verizon NJ proposes a finding of non-impairment <<<BEGIN PROPRIETARY END PROPRIETARY>>> from the total lines that rely on UNE-P that Verizon NJ excludes from its proposed non-impairment markets. In the proposed non-impairment portion of the MSA, UNE-Ps represent <<<BEGIN PROPRIETARY END PROPRIETARY>>> percent of the lines, and in the rest of the MSA (the “non-non-impairment” or “non-relief” portion), UNE-P represents <<<BEGIN PROPRIETARY END PROPRIETARY>>> percent of the total lines. Confidential Attachment SMB-12 provides these data separately by wire center for each of the two MSAs.

¹²⁰<http://www.rce.rutgers.edu/images/maps/nj-counties.gif>

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90. Within Verizon NJ's proposed non-impairment market, there are <<<BEGIN PROPRIETARY END PROPRIETARY>>> resale and UNE-P switched access lines,¹²¹ <<<BEGIN PROPRIETARY END PROPRIETARY>>>¹²² UNE loops, and <<<BEGIN PROPRIETARY END PROPRIETARY Verizon NJ-served retail lines¹²³ indicating that CLECs serve <<<BEGIN PROPRIETARY END PROPRIETARY>>> percent of the end user market (with resale, UNE-P, and UNE-L).

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¹²¹Verizon NJ response to RPA-TRO-97.

¹²²This quantity, which corresponds with Verizon NJ's Line Count Study, is provided in Verizon NJ's confidential response to RPA-TRO-96. Verizon NJ excluded CLECs that "provide solely data services over copper loop facilities, without offering voice services" and included EELs in its Line Count Study. West/Peduto Direct (Verizon NJ), at 22.

¹²³Verizon NJ response to RPA-TRO-94.

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Table 2

**Local Market Structure in Verizon NJ Proposed “Relief” Area
Compared with Local Market Structure Statewide**

Entry Mode	Verizon NJ Proposed “Relief”Area		Statewide	
	Lines	% of Market¹²⁴	Lines	% of Market
UNE-P, resale				
UNE Loop				
Verizon Retail				
Total Market				

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As Table 2 shows, this level of CLEC presence <<<**BEGIN PROPRIETARY**

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¹²⁴Numbers do not add to 100% due to rounding.

¹²⁵Verizon NJ responses to RPA-TRO-57. This number, according to Verizon NJ, excludes EELs and may include instances where CLECs offer data services only, and, therefore, is not precisely comparable to the UNE loop data shown for Verizon NJ’s proposed “relief” area..

¹²⁶Verizon NJ responses to RPA-TRO-55, RPA-TRO-57, and RPA-TRO-97.

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A finding of non-impairment would severely jeopardize competitive choice for mass market customers.

91. Attachment SMB-13 shows that local competition in <<<**BEGIN PROPRIETARY**
END PROPRIETARY>>> of the wire centers in Verizon NJ's proposed non-impairment markets is entirely UNE-P based. This attachment shows that <<<**BEGIN PROPRIETARY**
END PROPRIETARY>>> of the 96 wire centers encompassed by Verizon NJ's proposed non-impairment markets do not have *any* UNE-loop activity. Furthermore, this attachment demonstrates that over <<<**BEGIN PROPRIETARY** **END PROPRIETARY**>>> CLEC-served lines are *in areas where CLECs are not serving customers with self-provisioned switches, (i.e., they are using UNE-P)* and, therefore, a finding of non-impairment would jeopardize competitive choice for these customers.

92. Attachment SMB-14 shows UNE-loop activity within each of the two MSAs, by wire center, and further shows the numbers of loops associated with customers of different sizes. Among other things, Attachment SMB-14 shows that UNE loop presence <<<**BEGIN PROPRIETARY**
>>>**END PROPRIETARY** of the wire centers in Verizon NJ's proposed non-impairment markets. Table 3 summarizes the data in Attachment SMB-14, and shows the total numbers of wire centers with and without UNE-L activity in each of the four relief areas proposed by Verizon NJ.

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Table 3

**UNE-Loop Presence Is Non-Existent in Many Wire Centers in
Verizon NJ's Proposed Non-Impairment Region**

Market Area	Total Wire Centers in Relief Area	Wire Centers with Customers Served by UNE-L	Wire Centers without Customers Served by UNE-L
Newark, Zone 1			
Newark, Zone 2			
Camden, Zone 1			
Camden, Zone 2			
Total			

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Sources: Verizon responses to RPA 2-92 and RPA 2-104

93. Attachment SMB-15, which includes the same data as that shown in Attachment SMB-14, but instead grouped by county, shows that although CLECs may use self-provisioned switches to serve one wire center, such deployment does not necessarily translate into CLECs serving adjacent wire centers. For example, Confidential Attachment SMB-15 shows that <<<**BEGIN**

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94. The FCC stated that “...a switch can theoretically serve wide areas (provided that the costs of transporting traffic back to the switch are not cost prohibitive).”¹²⁷ However, the *absence* of any UNE loop activity in some wire centers within the same county boundaries as contains wire centers *with* UNE loop activity, and within Verizon NJ’s proposed market areas underscores the importance of differentiating between *theory* and *practice*. The evidence also demonstrates the infirmities of Verizon NJ’s proposed geographic market.

95. The disparity in the level of CLECs’ UNE loop activity among wire centers that Attachment SMB-15 shows is evidence that Verizon NJ’s proposed market boundary is too broad. Combined with the anomalies I described earlier regarding the inclusion of non-contiguous areas within a single market, this disparity demonstrates that Verizon NJ’s proposed geographic market boundaries are woefully unsupported and inadequate for the purpose of applying the FCC’s self-provisioning trigger.

¹²⁷TRO, footnote 1536, elaborating on ¶ 495.

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96. Although Verizon NJ fails to meet the FCC-established self-provisioning trigger *regardless of the geographic boundaries chosen*, should the Commission adopt an overly broad geographic market, this definition could lead to uneconomic outcomes in any future filings by Verizon NJ. The geographic market should include areas with similar market structure characteristics and should serve as a reasonable foundation for filings that Verizon NJ may make in future years. As the FCC observed:

The exact parameters of these geographic markets, however, cannot be defined nationally for switching because, as both incumbent LECs and competitive LECs agree, *there are extreme variations in population density, and thus wire center line densities, across the country.*¹²⁸

To meet the FCC-specified self-provisioning trigger, three or more CLECs must actually serve the entire market, including both residential and small business customers.

97. Attachment SMB-16 shows that residential consumers rely on CLECs' UNE-P based entry for competitive choice, and also shows that the degree of their reliance <<<**BEGIN**

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¹²⁸*Id.*, emphasis added.

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98. It is important to consider the substantial implications of prematurely foreclosing CLECs' access to unbundling switching. Residential consumers will bear the brunt of an erroneous finding of non-impairment because they will lose competitive choice and then, among consumer groups, will disproportionately depend on a single supplier of an essential service.

99. Attachment SMB-17 includes the CLECs that Verizon NJ identified in its direct testimony in purported support of its finding of non-impairment. Of the carriers, <<<**BEGIN PROPRIETARY**

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¹²⁹<<<**BEGIN PROPRIETARY**
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¹³⁰West/White Supplemental (Verizon NJ), at 6.

¹³¹<<<**BEGIN PROPRIETARY** **END PROPRIETARY>>>** response to Staff data requests.

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100. I examined the evidence to determine whether self-provisioning CLECs serve residential and small business customers *throughout* Verizon NJ's proposed relief area. As Attachment SMB-18 shows, <<<**BEGIN PROPRIETARY**

END PROPRIETARY>>>¹³² If CLECs are not actually serving residential customers throughout a market, they should not be counted toward the self-provisioning trigger. Alternatively, at least three CLECs must serve residential customers and at least three CLECs (and not necessarily the same CLECs) must serve small business customers.

101. As I discuss in more detail in Section III, the residential market is clearly a distinct customer class within the mass market. Verizon NJ charges different rates for residential and business local exchange service. Its ability to price discriminate is evidence of separate markets.¹³³

¹³²<<<**BEGIN PROPRIETARY**

END PROPRIETARY>>> Verizon response to RPA-TRO-96.

¹³³As I discuss in Section III, above, Attachment SMB-3 demonstrates that price discrimination differentiates areas within Verizon NJ's proposed geographic markets. This geographically-based price discrimination undermines the validity of Verizon NJ's proposed, excessively broad geographic areas.

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102. I analyzed information about the size of the customers that self-provisioning CLECs are serving in Verizon NJ's proposed non-impairment market. Attachment SMB-19 includes those CLECs that Verizon NJ identifies in Attachment 2 to its direct testimony, and for each CLEC, where the CLEC reported the data, the attachment shows the numbers of lines associated with locations of varying sizes. <<<**BEGIN PROPRIETARY**

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The Commission should examine the degree to which CLECs serve the entire mass market.

103. I also analyzed whether the CLECs that Verizon NJ identifies in its direct and supplemental testimony serve the *entire* mass market. Attachment SMB-20 includes those CLECs that serve the entire mass market. <<<**BEGIN PROPRIETARY**

END PROPRIETARY>>> Attachment

SMB-20 demonstrates that the self-provisioning trigger is not met, regardless of the geographic boundaries selected.

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104. As I discuss in Section III, the Commission, in fine-tuning its network unbundling rules, should clarify that the self-provisioning trigger is not met unless at least three CLECs self-provision switches and serve *both* residential and small business markets. Alternatively the Commission should clarify its rules to clarify that if the residential market is not served by at least three self-provisioning CLECs, then impairment exists in the residential market. Similarly, if the small business market is not served by at least three self-provisioning CLECs, impairment exists in the small business market. The goal of the 1996 Act is to encourage local competition for all consumers, not simply a subset of consumers.

105. The FCC-established self-provisioning trigger is not met in Verizon NJ's proposed geographic markets or in the wire center-based markets that I recommend. Attachments SMB-21 and SMB-22, which are based on Attachment 1 to Verizon NJ's supplemental testimony submitted in New Jersey BPU Docket No. TO03090705, demonstrate that the self-provisioning trigger is not met. Attachment 1 to Verizon NJ's supplemental testimony provides UNE loop information at a wire center level.

107. Attachment SMB-21 simply annotates Verizon NJ's Attachment 1 by adding a column that assesses whether the self-provisioning trigger is met in a particular wire center. If I recommend that the Commission exclude a particular CLEC from consideration in a particular wire center, I then specify the reason for such exclusion. The reasons for exclusion include the following:

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- The CLECs' presence is negligible and therefore should be discounted. I use the conservatively low threshold of 20 lines to measure the CLEC's presence in a wire center.
- The CLEC's presence is a consequence of a regulatory obligation rather than a

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business-motivated reason. <<<**BEGIN PROPRIETARY** .

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- The CLEC does not report the quantity of lines it serves.

108. Attachment SMB-22 includes the following information: CLLI code, location name, and the CLEC that serves some portion of the mass market. <<<**BEGIN PROPRIETARY**

END PROPRIETARY >>> do not provide information about the size of the customers that they serve, rendering it impossible for the Commission to assess whether and where they serve small business customers. In general terms, Attachment SMB-22 includes those wire centers within Verizon NJ's proposed non-impairment market with three or more self-provisioning CLECs that serve some customers, but, in most instances, do not serve *both* residential *and* business customers, and that, therefore, do not qualify for the trigger analysis.

109. In <<<**BEGIN PROPRIETARY** **END PROPRIETARY>>>** of the 96 wire centers encompassed by Verizon NJ's proposal, three or more CLECs serve a portion of but by no means all customer classes in the mass market in these wire centers. Because these CLECs do not serve all mass market customers, the FCC-established self-provisioning trigger is not met in any of these wire centers. Attachments SMB-21 and SMB-22 provide information about the geographic scope of CLECs' entry. These two attachments clearly demonstrate that CLECs compete on a wire

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center basis. None of the wire centers included in Attachment SMB-22 (i.e., the wire centers where CLECs are serving a submarket within the mass market) are contiguous.

110. Based on my analysis of the evidence submitted in New Jersey BPU Docket No. TO03090705, I conclude that Verizon NJ has not demonstrated that the self-provisioning trigger necessary to make a finding of non-impairment has been met. Although, as I demonstrate in Section III, geographic markets that correspond with wire centers are more appropriate than the ones that Verizon NJ proposes, *regardless* of whether the Commission adopts Verizon NJ's proposed market definitions or mine, Verizon NJ has failed to demonstrate that the self-provisioning trigger is met.

111. Furthermore, it is important to keep in mind the ultimate goal of this proceeding, that is, to ensure that customers have meaningful competitive options both now (before any finding of non-impairment is made) and after any such finding. If the Commission reaches a finding of non-impairment and then customers do *not* have substitutes for Verizon NJ's service (because the Commission drew the market boundary too broadly or placed undue weight on CLECs' precarious presence), this will have grave consequences for consumers. By contrast, if the Commission reaches a finding of impairment, thus enabling nascent competition to take hold, and then at a later date reaches a finding of non-impairment, then the harm in the interim to the industry is non-existent or negligible.

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112. Verizon NJ refers repeatedly to the “objective” aspect of the analytic exercise this proceeding requires.¹³⁴ Although Verizon NJ apparently would have regulators believe that this process simply represents a “mechanical” counting exercise, the successful resolution of this proceeding depends on the careful, judicious reasoning by the Commission. Certainly the use of “[o]bjective criteria can avoid the delays caused by protracted proceedings and can minimize administrative burdens,” and the FCC-specified thresholds are intended to provide “bright-line rules to guide the state commission,”¹³⁵ but the complexity of granular, unique markets within state boundaries ultimately requires a more in-depth and comprehensive assessment of local market structures than Verizon NJ implies exists. Verizon NJ fails to show that its proposed MSA-based market is appropriate.

Intermodal competition is irrelevant to a “track one” evaluation of non-impairment.

113. Verizon NJ asserted that “the FCC expressly includes ‘intermodal providers of service comparable in quality to that of the incumbent LEC’ for the purposes of the switching triggers.”¹³⁶

The portion of the FCC’s rules that Verizon NJ cites states, in pertinent part:

To satisfy this trigger [the local switching self-provisioning trigger], a state commission must find that three or more competing providers not affiliated with each other or the incumbent LEC, *including intermodal providers of service comparable in quality to that of the incumbent*

¹³⁴West/Peduto Direct (Verizon NJ), see, e.g., at 9, 15, 16, 26, 32.

¹³⁵TRO, ¶ 498.

¹³⁶West/Peduto Direct (Verizon NJ), at 22, citing 47 C.F.R. § 51.319(d)(2)(iii)(A)(1)-(2).

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LEC, each are serving mass market customers in the particular market with the use of their own local circuit switches.¹³⁷

The FCC also states that as “we evaluate evidence of intermodal deployment, we will consider to what extent services provided over these intermodal alternatives are comparable in cost, quality, and maturity to incumbent LEC services.”¹³⁸ The FCC explains its terminology as follows: “In this context, we refer to ‘intramodal competition’ as the competing provision of services over platforms using the same or similar technology. In addition, we refer to ‘intermodal competition’ as the competing provision of services over alternative technological platforms.”¹³⁹

114. Verizon NJ has failed to provide evidence of intermodal providers offering service to the mass market that is of *comparable quality* to its voice grade POTS. Cable telephony is not a comparable product and cannot be considered a substitute for voice grade local service, because, among other things, customers cannot purchase voice grade service apart from a cable package, and, therefore, the consumer’s cost of obtaining local service from a telephony provider exceeds the consumer’s cost of obtaining POTS. Similarly, wireless service is irrelevant to the application of the self-provisioning trigger because it does not offer a comparable quality to Verizon NJ’s POTS. Moreover, despite Verizon NJ’s assertion as to the relevance of intermodal providers, its specific filing does not appear to rely on their presence.

¹³⁷47 C.F.R. § 51.319(d)(2)(iii)(A)(1) (emphasis added). (Part (A)(2) applies to the application of the wholesale facilities trigger.

¹³⁸*TRO*, ¶ 97, footnote omitted.

¹³⁹*Triennial Review NPRM*, footnote 73.

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115. Verizon NJ also refers to Vonage and other carriers that use Voice Over the Internet Protocol (“VoIP”), and contends that the Board “should count Vonage among the carriers providing widespread mass market switched service in New Jersey.”¹⁴⁰ However, VoIP-based services are even less of a substitute for voice grade service than is cable telephony-based service. Significant regulatory challenges cast significant ambiguity over the development and use of VoIP,¹⁴¹ and, therefore, I do not believe that the Commission should rely in any way upon its existence in assessing the level of impairment in New Jersey. Although VoIP represents a significant industry development, clearly numerous regulatory and technical issues mean that it cannot be considered a substitute in the voice circuit switching market.

¹⁴⁰West/Peduto Direct (Verizon NJ), at 28.

¹⁴¹See, e.g., *In the Matter of IP-Enabled Services*, FCC WC Docket No. 04-36, Notice of Proposed Rulemaking, Rel. March 10, 2004; *In the Matter of Petition for Declaratory Ruling that AT&T’s Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, FCC WC Docket No. 02-361, Order, Rel. April 21, 2004; “Easing of Internet Regulations Challenges Surveillance Efforts,” *New York Times*, January 22, 2004, at 1, which discusses, among other things, discussions and disagreements about VoIP among the Justice Department, the Federal Bureau of Investigation, the Drug Enforcement Administration, and the Federal Communications Commission.

V. TRANSITION MECHANISMS

Background

116. In its *Order and Notice of Proposed Rulemaking*, the FCC established a two-phase plan to occur over a twelve-month period, which commenced with the publication of its rules in the *Federal Register* on September 13, 2004. In the interest of having “an orderly transition mechanism,” the FCC required continued availability over a six-month period of those elements that were provided under interconnection agreements as of June 15, 2004, and, during the subsequent six-month period, established a plan that is intended to mitigate disruption should the FCC reach a finding of non-impairment for any elements.¹⁴² The FCC seeks comment on whether there are circumstances “in which particular final rules would necessitate additional transition mechanisms apart from or beyond this second six-month phase.”¹⁴³

117. During the “interim” period, *i.e.*, the first six months after the mid-September publication of the *NPRM* in the *Federal Register*, ILECs must provide unbundled access to switching, enterprise market loops, and dedicated transport according to the rates, terms and conditions that applied under interconnection agreements as of June 15, 2004. The FCC permits changes in these rates, terms and conditions if they are or have been superseded by voluntarily negotiated agreements, an intervening

¹⁴²*NPRM*, ¶ 10.

¹⁴³*Id.*, ¶ 10.

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Commission order affecting specific UNE obligations, or a state public utility commission (“PUC”) order “raising the rates for network elements.”¹⁴⁴

118. Because state PUCs have authority to set rates for UNEs, which the *NPRM* would seem to undermine, the FCC should clarify and/or correct its language to refer to PUC orders that *change* the rates for network elements, rather than identifying only those state PUC orders *raising* rates.¹⁴⁵

119. The FCC also defines a “transition” period, which is the six-month period beginning the earlier of either mid-March 2005 (six months after the publication of the *NPRM* in the *Federal Register*) or the effective date of the FCC’s final unbundling rules. During this transition period, the FCC stated that in any areas of non-impairment for mass market switching, ILECs may charge a UNE-P rate equal to the *higher* of (1) the rate which the CLEC paid on June 15, 2004 *plus* one dollar or (2) the rate that a state PUC establishes between June 16, 2004 and mid-March 2005 *plus* one dollar. For areas of non-impairment for enterprise market loops and/or dedicated transport, ILECs may choose the *higher* of (1) *115 percent* of the rate which the CLEC paid on June 15, 2004 or (2) *115 percent* of the rate that a state PUC establishes between June 16, 2004 and mid-March 2005.

¹⁴⁴*Id.*, ¶ 29.

¹⁴⁵CLECs have petitioned the FCC to clarify that rate *decreases* are permitted. *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of the Incumbent Local Exchange Carriers*, CC Docket Nos. 04-313, 01-338, *Petition for Emergency Clarification and/or Errata*, submitted by the Association for Local Telecommunications Services, et al, August 27, 2004.

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These transitional rates would apply only to the embedded customer base and not to CLECs' new customers. Also, carriers are "free to negotiate alternative arrangements."¹⁴⁶

120. The FCC stated that "[s]ubject to the comments requested in response to the above *NPRM*, we intend to incorporate the second phase of the plan into our final rules." The FCC should eliminate this second phase from its final rules. The FCC's transitional rate rules contradict and undermine states' UNE ratemaking authority. Furthermore, it is hard to imagine ILECs willingly negotiating "alternative arrangements" with rates *less* than those that regulators permit. As a practical matter, because impairment exists for unbundled mass market switching throughout New Jersey, not only because of costly and excessively manual hot cut processes, but because, as I demonstrate in Section IV, the triggers are not met, the FCC's "transitional" rate increases would not apply to UNE-P in New Jersey. Nonetheless, the FCC-specified transitional rate increases represent poor public policy. Furthermore, if, contrary to my granular analysis and my recommendation, the FCC identifies particular markets in New Jersey where mass market switching impairment does not exist, then the transitional rate increases would harm consumers.

The FCC should re-affirm the transition plans that it set forth in the *TRO* and in the *TRO* rules.

121. The FCC should analyze the "transition" more broadly than simply determining the manner in which the rates, terms, and conditions will apply to UNEs during the next twelve months. As the FCC recognized in the *TRO*, the quality and cost of hot cut processes affect the likelihood of

¹⁴⁶*NPRM*, ¶ 29.

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disruption for consumers and the industry.¹⁴⁷ Until ILECs offer seamless hot cuts at cost-based rates, CLECs are impaired because they cannot transition from UNE-P to UNE-L without jeopardizing consumers' service quality and without confronting an insurmountable economic barrier.

122. *USTA II* does not diminish the significance of hot cuts to UNE-P. According to *USTA II*, hot cut costs contribute to but do not prove non-impairment. The Court stated:

Though certain sections of the Order suggest that impairment due to hot cut costs might be sufficiently widespread to support a general national impairment finding even in the absence of more “nuanced” determinations to be made by the state commissions, Order ¶¶ 459, 470, 473, the Commission at other points concludes that a national finding, without the possibility of market-specific exceptions authorized by state commissions, would be inconsistent with *USTA I*. See Order ¶¶ 186–88, 196, 425, 485, 493. At the very least, these latter passages demonstrate that the Commission’s own conclusions do not clearly support a non-provisional national impairment finding for mass market switches, and thus require us to vacate and remand.¹⁴⁸

The Court also stated that:

the Commission implicitly conceded that hot cut difficulties could not support an undifferentiated nationwide impairment finding. Order ¶¶ 425, 485, 493. Moreover, we made clear in *USTA I* that the Commission cannot proceed by very broad national categories where there is evidence that markets vary decisively (by reference to its impairment criteria), at least not without exploring the possibility of more nuanced alternatives and reasonably rejecting them. 290 F.3d at 425–26.

123. As I understand the Court’s reasoning, it faults the FCC in relying on hot cut costs and “difficulties” in its determination of impairment on a *national* level, but does not dispute the

¹⁴⁷*TRO*, ¶¶ 470, 472.

¹⁴⁸*USTA II*, at 21.

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relevance of hot cut costs and processes to the determination of impairment, provided the analysis is conducted in a sufficiently “nuanced” manner. Accordingly, it is not only valid under the *USTA II* ruling, but also imperative from a public policy and economic perspective, for the FCC to consider the status of hot cut processes and rates in its assessment of whether impairment exists in particular markets. For this reason, in this section of my Affidavit, I not only address the FCC’s general questions regarding its proposed twelve-month transition, but also address the specific status of hot cut processes and rates in New Jersey in order to enable the FCC to reach an informed decision about unbundled mass market switching in relevant New Jersey markets. Finally, I address the hot cut rules included in Sections 51.319(d)(ii)(“Batch cut process”) and 51.319(d)(iv) (“DS0 capacity end-user transition”) set forth in the *TRO*.

The major purposes of establishing rules for the transition are to encourage consumer and investor confidence in CLEC and ILEC operations, and to minimize consumer disruption when consumers migrate from one supplier to another supplier.

124. A smooth transition from UNE-P to UNE-L is essential in order to encourage consumer and investor confidence in CLEC and ILEC operations. Seamless hot cut processes are also critically important to prevent consumer disruption. Consumers must maintain access to service and “eliminating unbundled access to incumbent LEC switching on a flash cut basis could substantially disrupt the business plans of some competitors.”¹⁴⁹ A transition plan is required to allow sufficient time for competitors to change business and operational plans in light of changes to the regulatory regime and the need to change interconnection agreements. CLECs will have to develop new UNE-

¹⁴⁹*TRO*, ¶ 529.

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L provisioning systems, which may include the need to hire new employees, undergo training, revise billing systems, etc. CLECs must also have time between any regulatory decision and the time it is able to serve customers using alternative facilities. Otherwise CLECs would need to halt advertising and customer acquisition, thus harming consumers.

125. The FCC, in its unbundling rules, adopted a transition period for mass market loops and mass market switching. Specifically, the FCC adopted a three-year transition period for new line sharing arrangements¹⁵⁰ and an implementation plan for moving the embedded base of DS1 enterprise customers and mass market customers to competitive LECs' switches.¹⁵¹ The *TRO* requires that carriers adopt an implementation plan with the ILEC within two months of a state finding of non-impairment and carriers may not request access to unbundled local circuit switching five months after such a finding. Migration orders are to be submitted according to the following schedule (1) thirteen months after a non-impairment finding: CLEC must submit orders to migrate one-third of their customers; (2) twenty months after a non-impairment finding: CLEC must submit orders to migrate half of its remaining unbundled local circuit switching end users; and (3) twenty-seven months after a non-impairment finding: all remaining orders must be submitted to the ILEC.¹⁵²

126. *These provisions are critical and should be retained in the final rules in order to prevent consumer disruption.* In response to *USTA II*'s directive that the FCC, not state commissions, must

¹⁵⁰*Id.*, ¶ 265.

¹⁵¹*Id.*, ¶ 532.

¹⁵²*Id.*, ¶ 532, § 51.319(d)(iv)(A).

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determine whether impairment exists, the FCC need only make minor wording changes to the section of its rules governing “DS0 capacity end-user transition.” For example, in Section 51.319(d)(iv), the FCC can simply change the current language, “[i]f a state commission finds that no impairment exists in a market...” to “[i]f the FCC finds that no impairment exists...”¹⁵³

127. My analysis of granular data, whether assessed within the markets that I recommend, or even within the ill-supported markets that Verizon NJ recommends, demonstrates that Verizon NJ has failed to demonstrate non-impairment. If and when CLECs’ competitive presence and use of their own switches to serve mass market customers justify a finding of non-impairment in any particular market, then the FCC should not release Verizon NJ prematurely from its unbundling requirements for mass market switching. The irrevocable harm of prematurely discontinuing UNE-P, which is a critical stepping stone in the evolution of local competition, outweighs the purported harm of continuing Verizon NJ’s obligation to lease mass market switching to its competitors.

128. If the FCC at some future time, determines that one of the FCC-established triggers is met for a relevant market *and* that there is an acceptable batch hot cut process, then several transitional steps must precede the elimination of CLECs’ access to unbundled voice grade circuit switching. In its *Triennial Review Order*, the FCC directs states to establish a transition plan to migrate the embedded customer base. The FCC specifically determined that the “most critical aspect of any industry-wide transition plan is to avoid significant disruption to the existing customer base served via unbundled

¹⁵³Similar wording changes apply in the referenced section of the FCC’s rules (i.e., § 51.319(d)(iv)).

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loop circuit switching so that consumers will continue to have access to their telecommunications service.”¹⁵⁴ The FCC’s findings in the *TRO* regarding the need for a smooth transition, are entirely consistent with *USTA II* and are essential to protect consumers. As the FCC determined, “state commissions are well suited to monitoring the operational aspects of this migration . . . State commissions have strong incentives both to encourage competition (as a means of providing citizens of their states with a choice of service providers) as well as to foster new investment (as a means of promoting economic growth in their states).”¹⁵⁵

129. If the FCC should contemplate a finding of non-impairment, which I do not recommend for New Jersey, then it should open an investigation into the industry’s transition plan so that the FCC can ensure that states are managing “the transition in a way that promotes investment as well as continued choice for consumers.”¹⁵⁶ A smooth migration is essential to ensure that consumers have uninterrupted access to basic telecommunications service, and to the public switched telephone network.

High hot cut costs and excessively manual hot cut processes cause impairment in New Jersey.

Procedural History of the Board’s investigation of Verizon NJ’s hot cut processes and costs.

¹⁵⁴*TRO*, ¶ 529.

¹⁵⁵*Id.*, ¶ 531.

¹⁵⁶*Id.*, ¶ 531.

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130. The impetus for the ongoing New Jersey Board investigation into Verizon NJ's hot cut processes and costs arises out of the Board's recognition of the role that hot cuts play in transitioning customers to CLEC facilities. In its February, 2004 *Interim Order* the Board stated:

In its Order on Reconsideration [in UNE Docket No. TO00060356], the Board of Public Utilities ("Board") recognized the role that hot cuts play in transitioning customers to Competitive Local Exchange Carrier ("CLEC") facilities when it approved Verizon New Jersey, Inc.'s ("VNJ") promotional \$35.00 hot cut rate and advised VNJ that it would revisit the hot cut issue six months prior to the expiration of the promotional hot cut rate, and investigate whether automation of the hot cut process is possible.¹⁵⁷

At that time, the Board approved a Verizon NJ "promotional" rate for hot cuts through March 2004, and ordered that the issue would be examined again six months prior to the expiration of the hot cut rate. The Board opted to keep the hot cut matter distinct from the *TRO* proceeding. The Board, however, found that enough common issues of fact among the "single" hot cut and batch hot cut proceedings supported consolidation of the two, and commenced a separate proceeding in a collaborative technical workshop to investigate both matters together. Verizon NJ filed updated rate and cost information, upon which discovery and responsive testimony by parties were filed. Due to various delays, the promotional hot cut rate was extended until conclusion of the instant phase of this proceeding. Evidentiary hearings in this matter were held at the Board on May 24 and 25, 2004. Briefs and reply briefs were filed July 2 and July 16, 2004, respectively.

¹⁵⁷*In the Matter of the Implementation of the Federal Communications Commission's Triennial Review Order*, BPU Docket No. TO03090705, *Interim Order*, February 19, 2004.

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131. A well-functioning hot cut process is essential to ensure that consumers can migrate among suppliers without service disruption. Mass market customers have an expectation that when they switch to a new service provider, the installation will be timely and transparent. As the FCC opined in its *Triennial Review Order*, “competition is meant to benefit consumers, and not create obstacles for them.”¹⁵⁸ Furthermore, if hot cut rates are set too high, then competitors will find it prohibitively expensive to migrate customers from Verizon NJ’s switches to their own switches, thereby leaving New Jersey consumers with fewer options.

132. An inefficient and inadequate hot cut process, with prices based on inflated costs, represents a significant barrier to local telecommunications competition in the mass market. Residential and small business customers, who lack the telecommunications redundancies that large businesses typically possess, have little patience or understanding for service delays and interruptions. Furthermore, the mass market offers minimal profit margins, which means that over-priced hot cuts will prevent local competition from evolving. The likelihood of the mass market benefitting from the service quality and service choices that local competition can bring depends critically on the establishment of a trouble-free, reasonably priced system that enables consumers to migrate easily among carriers, and one that does not require a household or small business to *disconnect* its Internet access.

133. Verizon NJ, however, lacks an economic incentive to foster the development of such a process because the consequences of the *status quo* favor Verizon NJ: high hot cut prices

¹⁵⁸ *TRO*, ¶ 467.

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discourage Verizon NJ's competitors from serving the market, and disgruntled mass market customers who experience service delays and disruptions will likely stay with or return to the incumbent carrier. The lack of an economic incentive on the part of Verizon NJ combined with CLECs' lack of negotiating strength mean that regulatory intervention is essential to ensure that the market place functions efficiently. Continuing regulatory involvement by the New Jersey Board and by the FCC is essential to ensure that Verizon NJ's hot cut processes work properly, efficiently, and sufficiently, and that Verizon NJ offers hot cuts to its competitors at a fair price.

134. As my attachments to this Affidavit demonstrate, CLECs' reliance on UNE-P varies significantly among Verizon NJ's central offices, which suggests that Verizon NJ must be well-prepared to handle wide variations in demand for hot cuts. Furthermore, mass market customers rely disproportionately on UNE-P in order to obtain competitive choice, as Attachments SMB-12 through SMB-20 and SMB-22 demonstrate. Therefore, Verizon NJ's ability to handle hot cut orders and the prices CLECs must pay for hot cuts affect directly the prospects (if any) for mass market competition.

Verizon NJ's proposed batch hot cut process is cumbersome and unduly constrains CLECs' control over their customers' telecommunications choices.

135. Hot cuts involve coordination (communication between Verizon NJ and CLECs) and provisioning (the disconnection of the UNE-L from Verizon NJ's switch and the reconnection to a CLEC's switch). All three hot cut processes that Verizon NJ proposed in New Jersey's hot cut proceeding are excessively manual, are not seamless, do not accommodate all types of loops (*i.e.*, loops served by IDLC, CLEC-to-CLEC migrations, EELs, and lines with DSL), are not scalable, and

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are not timely.¹⁵⁹ Verizon NJ failed to address or to suggest a remedy for the inherent weakness in the status of carrier-to-carrier interactions, namely that Verizon NJ lacks any economic incentive to improve its hot cut process. Verizon NJ did not demonstrate that it is seeking to identify ways to improve its process.¹⁶⁰

136. Verizon NJ's lengthy time frame for completing batch hot cuts would jeopardize CLECs' relationship with their mass market customers. In today's environment, Verizon NJ completes a typical hot cut in five days.¹⁶¹ Verizon NJ proposes to complete batch-processed migration in an interval lasting between six and twenty-six *business* days, depending on the amount of migration activity in a given central office, and, therefore, the shortest calendar period would be eight days and the longest could be as long as 38 days (an interval of 26 business days entails six weekends).¹⁶² Verizon NJ will not provide assurances to CLECs that, even if they have large batch hot cut orders, the interval will be seven rather than, say, seventeen days.¹⁶³

Verizon NJ has not demonstrated that its proposed hot cut process is sufficiently scalable to accommodate high volumes of hot cut orders.

¹⁵⁹Ex. MCI-9, at 7.

¹⁶⁰Ex. MCI-9, at 22.

¹⁶¹T. 101:22-101:23, May 25, 2004 (Thomas Maguire).

¹⁶²T:43, May 25, 2004 (Thomas Maguire).

¹⁶³ T. 79:2-81:3, May 25, 2004 (Thomas Maguire); Ex. Cavalier-1, at 11.

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137. The evidence in the New Jersey Board’s proceeding raises concerns about Verizon NJ’s ability to handle high volumes of hot cut orders in a trouble-free manner.¹⁶⁴ Furthermore, Verizon NJ glosses over the challenges of increasing and training its work force to handle unprecedented volumes of hot cuts. Verizon NJ would need to recruit, hire, and train many more management and technical employees, and as one CLEC witness stated, “simply ‘throwing bodies’ at a problem is seldom a viable solution.”¹⁶⁵ Furthermore, Verizon NJ would need to increase its staff significantly.¹⁶⁶ Although in New York, Verizon persuaded the state PUC that “it is possible for Verizon to hire and train additional workers to perform a significantly expanded volume of hot cuts that will necessarily be required if the availability of the Unbundled Network Elements Platform (UNE-P) is phased out in the future,”¹⁶⁷ in New Jersey, Verizon NJ did not provide persuasive evidence of its ability to substantially increase its volume of hot cuts *without* jeopardizing service quality. At risk is the viability of CLECs’ operations and mass market customers’ service quality, with negligible, if any, risk to Verizon NJ. The FCC should heed the concern expressed by one CLEC that “here, where it is only the competitive LECs that will be hurt by Verizon NJ’s failures,

¹⁶⁴Ex. Bridgecom/TruCom-1-P, at 5-6; Ex. ATT-HCUT-2-P; Ex. MCI-8.

¹⁶⁵Ex. Bridgecom/TruCom-1, at 7-8.

¹⁶⁶Ex. MCI-8, at 59-60, footnote omitted.

¹⁶⁷*Proceeding on Motion of the Commission to Examine the Process and Related Costs of Performing Loop Migrations on a More Streamlined (e.g., Bulk) Basis*, New York Public Service Commission Case No. 02-C-1425, *Order Setting Permanent Hot Cut Rates*, Issued and Effective August 25, 2004 (“New York Hot Cut Order”), at 1.

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the leap of faith that Verizon NJ seeks is a leap too far. Verizon NJ needs to definitively establish, not simply declare that it can handle hot cut volumes far in excess of anything it has previously faced.”¹⁶⁸ Customers will blame the CLEC, not Verizon NJ, for service quality failures and CLECs’ inability to modify customers’ orders during the potentially multi-week “holding pattern.” This consequence, of course, harms CLECs and customers, without any apparent consequence to Verizon NJ.

Verizon NJ’s batch hot cut process has not been adequately tested, nor is it sufficiently automated.

138. CLECs have raised serious concerns about Verizon NJ’s hot cut process, chief among them that Verizon NJ relies excessively on manual intervention. CLECs identified and described in detail automated alternatives to Verizon NJ’s extremely manual processes.¹⁶⁹ Verizon NJ’s hot cut process lacks automated processes and includes redundant and/or unnecessary steps and excess hand-offs among internal organizations.¹⁷⁰ The evidence in New Jersey’s proceeding demonstrates that Verizon NJ’s hot cut processes are cumbersome, inadequate, and fail to incorporate forward-looking ordering and provisioning practices. Furthermore, Verizon NJ’s reliance on “negotiated” intervals and its vague speculations about when it might perform batch hot cut orders are anti-competitive.

¹⁶⁸Ex. Bridgecom/TruCom-1, at 12.

¹⁶⁹*See, e.g.*, Ex. Bridgecom/TruCom-1, at 18. Ex. BridgecomTruCom-1, at 19-36; Ex. ATT-HCUT-1, at 22-28; 46-61; Ex. MCI-9, at 3-4; 7-56.

¹⁷⁰Ex. ATT-HCUT-1, at 22-23, 30-31, 47.

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Verizon NJ has failed to demonstrate that it can scale its operations to handle large volumes of conversions from UNE-P to UNE-L, and, therefore, absent corrective action, Verizon NJ's inadequate process will jeopardize CLECs' relationships with their consumers and residential and small business consumers' trouble-free migration among carriers.

Consumers' demand for digital subscriber line service underscores the importance of establishing a hot cut process that enables customers to retain their DSL service while migrating to a different carrier for voice service.

139. Verizon NJ's hot cut process presently does not accommodate customers with combined voice and data needs, *i.e.*, a customer with digital subscriber line ("DSL") service and voice service being provided over the same line.¹⁷¹ Until it resolves this issue, however, Verizon NJ essentially proposes a "cold cut" for these customers. Verizon NJ lacks a compelling economic incentive to resolve the operational problems associated with enabling hot cuts for voice without jeopardizing customers' data services. Industry discussions do not address sufficiently the fundamental and inherent advantage that Verizon NJ possesses in attracting and retaining customers that seek high speed access.

140. In order to handle a DSL customer in a hot cut process, the customer must *disconnect* the line. Verizon NJ's witness testified that "at this point in time we would require the customer to

¹⁷¹Ex. Bridgecom/TruCom-1, at 18. Ex. BridgecomTruCom-1, at 19-36; Ex. ATT-HCUT-1, at 22-28; 46-61; Ex. MCI-9, at 3-4; 7-56.

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disconnect their DSL . . . so they could be included in a batch.”¹⁷² Requiring customers to *cancel* their DSL in order to be included in a batch hot cut represents a significant operational and economic barrier to CLECs’ ability to migrate customers. Common sense dictates that those customers that seek high speed access are more likely to be a part of the potential *demand* for CLECs’ voice services, *i.e.*, be willing to migrate to CLECs for voice service and to experiment with other telecommunications services. On the *supply* side, common sense dictates that CLECs are more likely to market to customers with sophisticated and broad telecommunications needs.

Verizon NJ’s Proposed Hot Cut Cost Study is Fundamentally Flawed.

141. As the evidence in the New Jersey proceeding demonstrates, not only are Verizon NJ’s proposed rates too high, but the existing, interim \$35.00 hot cut rate is also excessive. I do not advocate setting rates for the explicit goal of facilitating CLECs’ entry and success in the local market. However, Verizon NJ has failed to justify its proposed hot cut cost. Verizon NJ proposes a service order charge of \$23.87, an installation charge of \$66.55 and an IDLC surcharge of \$119.27.¹⁷³ The inflated costs result from numerous ill-supported factors, among which are assumptions of excess manual intervention, high fall out, and mis-classification of recurring costs as

¹⁷²T.83:8-83:14, May 25, 2004 (Thomas Maguire).

¹⁷³Ex. Cavalier-3 (Verizon NJ response to Cavalier-39).

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non-recurring costs. Verizon NJ failed to demonstrate that its estimates and adjustment factors are valid for among others, the following reasons:

- The task times corresponding with today's environment are based on a statistically flawed survey.
- The typical occurrence factors are inadequately documented and supported.
- The forward-looking adjustment factors are entirely undocumented and insufficient, and fail to transform Verizon NJ's embedded cost study into a forward-looking study that conforms with total element long run incremental cost ("TELRIC") principles.
- Verizon NJ's labor rates are excessive.
- Verizon NJ's gross revenue loading factor is inflated and ill-supported.

143. Under Verizon NJ's proposal, the rate for a basic hot cut for a single residential customer for one line would be \$90, approximately 30 percent higher than the cost if the same order were handled through a batch hot cut at the proposed rate of \$69.59.¹⁷⁴ In contrast with batch orders, which Verizon NJ proposes to complete within a six to 26 day interval, Verizon NJ completes a basic order within a five-day interval, and, furthermore the CLEC can specify the hour and date.¹⁷⁵ As the following tables show, Verizon NJ's proposed hot cut rates vastly exceeds those proposed by the CLECs in the New Jersey proceeding.

¹⁷⁴T. 47:20-47:23, May 25, 2004 (Bruce Meacham).

¹⁷⁵T. 48:2-48:19, May 25, 2004 (Bruce Meacham).

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Table 4

Hot Cut Rate Proposals in BPU Docket No. TO03090705

AT&T/Broadview	Source: Exhibit ATT-HCUT-1, at 66-67
Initial Basic	\$9.93
Additional Basic	\$4.48
Project Hot Cut Initial	\$4.50
Project Hot Cut Additional	\$4.29
Conversent	Source: Attachment AASM-3
Connect: Initial	\$5.41
Connect: Additional	\$4.99
Disconnect: Initial	\$0.74
Disconnect: Additional	\$0.57
MCI	Source: Responsive Testimony of Earle Jenkins, at 4
Coordinated Hot Cut Initial	\$7.36
Coordinated Hot Cut Additional	\$6.11
Mass Market Hot Cut Initial	\$6.38
Mass Market Hot Cut Additional	\$5.13
VNJ	Source: T:47; ATT-VNJ-207(Exh III-A-P (revised))
Initial Basic	\$90.00
Batch Hot Cut	\$69.59

144. Furthermore, Verizon NJ's proposed hot cut rates exceed those approved by regulators for Verizon in Pennsylvania and Virginia, and even those recently established in New York. In sharp

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contrast with Verizon NJ's proposed hot cut rates, in Pennsylvania, the hot cut rate is \$1.44.¹⁷⁶ The FCC set Verizon VA's rates at \$5.01 and \$4.84 for POTS/ISDN BRI Migration (UNE Loop) and POTS/ISDN BRI Install (UNE Loop), respectively.¹⁷⁷ The New York Public Service Commission approved basic 2-wire, large job, and batch hot cut rates at \$42.36, \$33.84, and \$28.17, respectively, which are approximately half the amounts proposed by Verizon New York.¹⁷⁸ Although the New York Public Service Commission appropriately reduced Verizon's proposed rates to remedy flaws in its hot cut cost studies, I do not believe that the modified hot cut cost studies in New York sufficiently incorporate automated processes.

¹⁷⁶Verizon Pennsylvania Inc. Tariff PUC No. 216, Section 3, Part C.1.a., POTS Analog 2-wire, 6th Revised Sheet 6, Effective March 26, 2004, In compliance with Order of the Pennsylvania Public Utility Commission entered December 11, 2003 in Docket No. R-00016683.
https://retailgateway.bdi.gte.com:1490/viewdocact.asp?system_id=1552485&lib=TMPI_PCDP_LIB&doc=76684&checkout=false&fileExt=.PDF&Frameset=Created

¹⁷⁷Verizon Virginia Non-Recurring Charge Elements at Appendix A - Rates, *In the Matter of Petition of Worldcom, Inc., Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia, Inc., and for Expedited Arbitration*, FCC CC Docket No. 00-218; *In the Matter of Petition of AT&T Communications of Virginia Inc., Pursuant to Section 252(e)(5) of the Communications Act of the Jurisdiction of the Virginia Corporation Commission Regarding Interconnection Disputes with Verizon Virginia, Inc.*, FCC CC Docket No. 00-251, Memorandum Opinion and Order, Rel. January 29, 2004

¹⁷⁸*New York Hot Cut Order*, at 3.

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Mass migration of the embedded UNE-P customer base should not occur until Verizon NJ proposes a hot cut process that minimizes consumer disruption and Verizon NJ is held accountable for its performance.

145. The evidence in New Jersey's proceeding raises credible concerns about Verizon NJ's ability to handle large volumes of hot cuts without jeopardizing residential and small business customers' service quality.¹⁷⁹ The potential quantities and durations of service outage that the evidence in the New Jersey proceeding indicates would likely occur would be harmful not only for mass market customers, but also for CLECs that are striving to attract and retain new customers. Furthermore, Verizon NJ's present carrier-to-carrier reporting system is inadequate because it does not include sufficient indicators for which it isolates its hot cut performance.

146. Customers will hold CLECs accountable for the quality of service they provide, even if Verizon NJ causes the service disruptions or service delays. If customers are dissatisfied in the first few weeks with their new service, then they will likely return to Verizon NJ. Therefore, CLECs' lack of control over their customers during the batch hot cut process, which may last as long as five weeks, severely hampers the customer relationships that they have sought to establish. Customer dissatisfaction benefits Verizon NJ, and, therefore, there are no inherent economic incentives for Verizon NJ to make the UNE-P to UNE-L transition as painless and trouble-free as possible.

¹⁷⁹Ex. ATT-HCUT-2, at 39-40.

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Metrics and incentive payments are essential to enable the Board and the industry to assess the performance of Verizon NJ's individual and batch hot cuts.

147. Verizon NJ lacks the incentive to perform hot cuts promptly and seamlessly. Metrics and incentive payments are essential to address the utter absence of incentives for Verizon NJ to convert loops seamlessly from its switches to CLECs' switches. Although a hot cut necessarily entails service interruption, it is essential to minimize the service outage and to monitor its duration. Verizon NJ has failed to demonstrate that it has analyzed adequately the impact of its proposed batch hot cut processes on mass market customers' service quality.

148. In the FCC's *Triennial Review* proceeding, the ILECs cited the FCC's determination in the 271 proceedings that the BOCs are meeting service quality measures for hot cuts, and that service quality data continues to be satisfactory as volumes have grown. However, the FCC found that "the number of hot cuts performed by BOCs in connection with the section 271 process is not comparable to the number that incumbent LECs would need to perform if unbundled switching were not available for all customer locations served with voice-grade loops."¹⁸⁰ Furthermore:

. . . these [Section 271] orders examined the adequacy of hot cuts at a time when competitive LECs were principally using unbundled local circuit switching to compete for mass market customers. Indeed, the BOCs frequently relied on evidence of customers being served by unbundled loops combined with unbundled local circuit switching to support their Track A findings of sufficient facilities-based competition.¹⁸¹

¹⁸⁰ *TRO*, ¶ 469.

¹⁸¹ *Id.*, footnote 1435.

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149. In addition to failing to meet the triggers, Verizon NJ has failed to demonstrate that it offers a seamless hot cut process at cost-based rates. Therefore, until the Board informs the FCC that Verizon NJ has improved its hot cut process, the FCC should find that CLECs are impaired in New Jersey without access to unbundled mass market switching. The following steps are necessary: reducing ordering intervals; accommodating all forms of hot cuts to enable seamless migration regardless of which carrier or type of loop is serving a customer; and conducting a comprehensive trial of its batch hot cut well in advance of any potential elimination of UNE-P. A carefully designed system of metrics and incentive payments is essential to address the absence of economic incentives for Verizon NJ to provide hot cuts that are transparent to consumers and efficient for CLECs. The New York Public Service Commission recently came to a similar conclusion: “Given the importance of the loop migration process to maintaining an open marketplace and the inherent difficulty in predicting how the process will handle high volumes, we are mandating the establishment of performance standards and enforcement incentives as critical to ensure timely and high quality hot cuts.”¹⁸²

¹⁸²*New York Hot Cut Order*, at 1.

VI. APPLICATION OF THE UNBUNDLING FRAMEWORK

The use of triggers to determine whether impairment exists is appropriate *if and only if the FCC establishes appropriate criteria for their application and defines markets properly.*

150. The FCC seeks comment on how to apply its unbundling framework “to make a determination on access to individual network elements.”¹⁸³ The FCC's framework for the determination of access to unbundled network elements is made up of two “triggers” and a “potential deployment” analysis for evaluating whether impairment exists in a given market.¹⁸⁴ The Commission requires that only one of the three standards be met for a finding of non-impairment. The first trigger is the “self-provisioning trigger,” which, to be satisfied, generally requires that three or more competing providers are serving mass market customers with their own local circuit switches.¹⁸⁵ The second trigger (“competitive wholesale facilities trigger”) requires that two or more CLECs offer wholesale local circuit switching service to customers using DS0 capacity loops and their own switches.¹⁸⁶ The two triggers examine actual deployment by CLECs, and have been termed “Track 1” of the impairment analysis by some parties. The FCC's rules also include an “analysis of potential deployment” which permits a finding of non-impairment if there is a determination that self-provisioning of local switching is economic based on particular criteria.¹⁸⁷ This examination of potential deployment has been referred to as “Track 2.” The FCC’s framework

¹⁸³*NPRM*, ¶ 11.

¹⁸⁴*TRO*, ¶ 494.

¹⁸⁵*Id.*, ¶ 501.

¹⁸⁶*Id.*, ¶ 504.

¹⁸⁷*Id.*, ¶ 506.

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also considers intermodal providers of service “comparable in quality to that of the incumbent LEC” to qualify in the trigger analysis.¹⁸⁸

151. The two triggers, which rely on evidence of *actual* deployment of switches *actually* serving mass market customers, are sound, provided that the FCC defines markets appropriately. As I discuss in Sections III, and IV, above, among other things, it is essential that residential *and* business customers be served. Also, if, contrary to my recommendation, the FCC “counts” SBC (or any other ILECs that make negligible inroads into other ILECs’ “home” regions), in its application of the self-provisioning trigger, I recommend that the FCC increase the self-provisioning trigger in its network unbundling rules from three to four. Furthermore, I recommend that the Commission determine that, at present, there are not any intermodal providers of service “comparable in quality to that of the incumbent LEC.”

The FCC’s “analysis of potential deployment” is administratively unworkable because it invites widely disparate views of the likelihood of CLECs’ entry into a particular market being profitable.

152. The FCC’s “analysis of potential deployment” relies on regulators’ assessment of the evidence of actual deployment, operational barriers, and economic barriers.¹⁸⁹ Although Verizon NJ did not submit a business case analysis in New Jersey, I had the opportunity to analyze and apply the potential deployment (or “Track 2”) analysis in my review of Qwest’s mass market impairment filing in Utah. Qwest’s claim of non-impairment was based in part on the self-provisioning trigger

¹⁸⁸§ 51.319 (d)(2)(iii)(A) through (d)(2)(iii)(C).

¹⁸⁹§ 51.319 (d)(2)(iii)(B)(1) through (d)(2)(iii)(B)(3).

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and in part on the analysis of potential deployment. In Utah (and other Qwest-served states), Qwest and AT&T submitted competing models that are intended to analyze whether a competing carrier could economically serve the market without access to the incumbent's switch. The models incorporate a wide range of assumptions regarding market penetration, customer churn rates, costs, revenues, geographic market definition, and the time horizon over which the business case should be conducted.¹⁹⁰

153. The Court, in *USTA II*, expressed its doubts about the Commission's analysis of potential deployment in the following manner:

The touchstone of the Commission's impairment analysis is whether the enumerated operational and entry barriers "make entry into a market uneconomic." Order 84. Uneconomic by whom? By *any* CLEC, no matter how inefficient? By an "average" or "representative" CLEC? By the most efficient existing CLEC? By a hypothetical CLEC that used "the most efficient telecommunications technology currently available," the standard that is built into TELRIC? Compare 47 CFR § 51.505(b)(1). We need not resolve the significance of this uncertainty, but we highlight it because we

¹⁹⁰*In the Matter of a Proceeding to Address Actions Necessary to Respond to the Federal Communications Commission Triennial Review Order Released August 21, 2003*, Public Service Commission of Utah Docket No. 03-999-04, Direct Testimony of Byron S. Watson on behalf of Qwest Corporation, filed January 13, 2004 (Mr. Watson presented Qwest's CLEC Profitability Model, or "CPRO"); *In the Matter of a Proceeding to Address Actions Necessary to Respond to the Federal Communications Commission Triennial Review Order Released August 21, 2003*, Public Service Commission of Utah Docket No. 03-999-04, Direct Testimony of Michael R. Baranowski on behalf of AT&T Communications of the Mountain States, Inc. and TCG Utah, filed January 13, 2004 (Mr. Baranowski presented AT&T's Business Case Analysis Tool, or "BCAT").

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suspect that the issue of whether the standard is too open-ended is likely to arise again.¹⁹¹

154. Although theoretically appealing, this method of assessing impairment ultimately would shed minimal light on the question of impairment yet would expend substantial administrative resources to address. Furthermore, even if the FCC determined that a CLEC *could* theoretically enter a market, this possibility alone is irrelevant to the mass market consumer who only benefits from the *actual* entry by a CLEC. For these reasons, the FCC should eliminate the potential deployment analysis from its final network unbundling rules.

155. Although I recommend that the FCC eliminate Section § 51.319 (d)(2)(iii)(B)(1) through (d)(2)(iii)(B)(3) from its rules, it should not eliminate Section § 51.319 (d)(2)(iii)(B)(4), which requires the establishment of a the “cutoff” between mass market and enterprise customers. The FCC intended that states would make this determination “as part of the economic and operational analysis” required to assess potential deployment.¹⁹² However, if the Commission adopts my recommendation, it will eliminate the potential deployment analysis. As I understand the *USTA II* directives, it is now the FCC, and not the state, that must define mass market. I recommend that it

¹⁹¹*USTA II*, at 25, emphasis in original. The Court noted that in light of its remand it need not review the FCC's impairment standard, as it "finds concrete meaning only in its application, and only in that context is it readily justiciable." However, the Court did offer a few "observations." *Id.*, at 24.

¹⁹²*TRO*, ¶ 497.

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do so unambiguously by defining up to 24 DS0 lines as mass market, for the reasons I discuss in more detail in Section III, above.

156. If, contrary to my recommendation, the FCC does not eliminate the analysis of potential deployment from its final rules, I recommend that, in evaluating the three criteria relating to potential deployment, it afford the greatest weight to the criterion regarding evidence of actual deployment. Among the three criteria that the FCC identifies in its unbundling rules for making a “Track 2” analysis, the actual deployment of switches provides the strongest evidence of CLECs’ assessment of the potential profitability of market entry (although, until the CLEC uses the switch to serve residential and business customers throughout the relevant geographic market, the evidence is still significantly weaker than information about quantities and locations of customers actually being served).

157. In its analysis of economic barriers, the Commission likely will be assessing competing business case models. The Commission should require ILECs and CLECs, in their design of such models, to compare the projected profitability of (1) serving residential and business customers with (2) serving only business consumers. In those instances where including the residential market in a cash flow analysis diminishes the projected net revenues, one can reasonably assume that rational CLECs will not serve residential customers. If the inclusion of residential customers reduces projected profits in a given market, the FCC should determine that the evidence is not sufficient to make a finding of non-impairment under “Track 2.” If the FCC decides to retain the analysis of potential deployment in its final rules, then it should expand the rules to include an explicit directive

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that ILECs separately demonstrate the profitability of serving (1) residential and business customers and (2) serving only business customers. Furthermore, ILECs' applications should disaggregate the financial analyses to a wire center level. These distinct analyses will assist the FCC in assessing the plausibility of CLECs serving the *entire* mass market.

158. Finally, the use of triggers to determine whether impairment exists is appropriate *if and only if the FCC establishes appropriate criteria for their application and defines markets properly.*

VII. CONCLUSIONS AND RECOMMENDATIONS

159. Based on my examination of granular data in New Jersey's local market, I determined that, regardless of whether the FCC adopts Verizon NJ's proposed geographic markets or wire centers, as I propose, CLECs would be impaired without access to unbundled mass market local switching in New Jersey's local markets. Furthermore, a premature finding of non-impairment would harm consumers by denying them competitive choice, and the harm would fall disproportionately on residential consumers.

160. If the FCC determines that additional data are required in order to assess whether impairment exists, it should afford all parties an opportunity to review the data and the FCC should conduct evidentiary hearings regarding the analysis of such data.

161. Based on my participation in three state impairment proceedings, and in particular, on my analysis of granular information submitted by Verizon NJ and CLECs in New Jersey, I conclude that Verizon NJ has failed to demonstrate that there are *any* mass markets in New Jersey in which the FCC, in applying its self-provisioning trigger, can determine that there is no impairment.

162. Among my other major conclusions and recommendations are the following:

- The FCC should adopt the wire center as the relevant geographic market for assessing whether impairment exists.
- The FCC should modify its rules to clarify that the delineation between the mass and enterprise markets coincides with 24 DS0 channels.

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- The FCC should retain the self-provisioning trigger and, in applying the trigger, should require that *at least three* self-provisioning CLECs serve the entire relevant market, including both residential *and* business customers.
- Also, if, contrary to my recommendation, the FCC “counts” SBC (or any other ILECs that make negligible inroads into other ILECs’ “home” regions), in its application of the self-provisioning trigger, I recommend that the FCC increase the self-provisioning trigger in its network unbundling rules from three to four.
- Furthermore, I recommend that the Commission determine that, at present, there are not any intermodal providers of service “comparable in quality to that of the incumbent LEC.”
- The FCC should eliminate the potential deployment trigger. If, contrary to my recommendation, the FCC retains the potential deployment trigger, it should require ILECs to demonstrate that the inclusion of the residential market in the business case model *enhances* rather than *diminishes* the profitability of CLEC entry.
- The FCC should eliminate the anti-consumer rate increases that it proposes during the “transition” period.
- Verizon NJ does not yet offer a sufficiently automated hot cut process at reasonable rates.
- Until such time as the New Jersey Board approves a seamless hot cut process at cost-based rates, the FCC should not reach a finding of non-impairment in any New Jersey mass market.

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